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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1932.

No. 128

WABASH VALLEY ELECTRIC COMPANY,
Appellant,

vs.

RALPH M. YOUNG, (substituted for Frank T. Singleton) *et als.*,
Appellees.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF INDIANA.

BRIEF FOR APPELLANT.

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BRIEF FOR APPELLANT.

Appeal From Final Decree.

This is an appeal from a decree entered February 26, 1932, (R. 170-1) by the District Court of the United States for the Southern District of Indiana, dismissing appellant's bill of complaint for want of equity and dissolving a temporary injunction. The petition for appeal with the assignment of errors was presented and allowed May 10, 1932 (R. 172-9).

Bill of Complaint.

February 27, 1929, appellant filed its bill of complaint (R. 1-15) against the members of the Public Service Commission, the Attorney General and Governor of Indiana, to enjoin the enforcement of an order of the Public Service Commission of Indiana (R. 15-53) made January 26, 1929, effective February 1, 1929, prescribing the rates and charges to be made by the appellant for its electrical service rendered in the city of Martinsville, Indiana.

The bill has a double aspect. First, it presents the claim of the appellant that its entire interconnected electrical property, serving a number of communities and constituting a single operating unit, is the rate base, and on this basis the rates imposed by the order, when considered in connection with the rates in effect in the other communities served by appellant's system, are confiscatory. Second, it alleges that even if the claim of the appellees that (a) the Martinsville property should be segregated and (b)

a "gateway" price fixed for energy, should be applied, nevertheless if the property is allocated according to its actual use and a fair charge is made for electrical energy at the "gateway" the rates are confiscatory.

The bill alleges that this is a suit of a civil nature in equity where the amount in controversy exceeds, exclusive of interest and costs, the sum of three thousand dollars; that appellant is an Indiana corporation organized under the laws of Indiana, engaged in supplying the public with electrical energy for light, heat and power; that the value of the property of appellant used and useful in said public service is not less than $5,026,437; that under the rates prescribed appellant will be prevented from earning more than 4.62 per cent per annum upon the value of such property; that this is less than a fair and reasonable return; that the rates prescribed in said order are confiscatory of appellant's property used and useful in furnishing electrical service to the public; that thereby appellant is deprived of its property without due process of law and is denied the equal protection of the laws in violation of its rights under the Fourteenth Amendment to the Constitution of the United States.

The bill further alleges (R. 11 and 12) that even when tested according to the method used by the Public Service Commission (*i. e.*, that of segregating the Martinsville property and fixing a "gateway" price for electrical energy delivered over appellant's electrical transmission lines to the substation at Martinsville for local distribution) the rates fixed by the commission are inadequate, unfair, unreasonable and confiscatory and take appellant's property without due process of law; that the value of the used and useful "power system" property of appellant (*i. e.*, property other than the local distribution systems within communities) is $3,360,999.16 (R. 6-7); that appellant in 1928

delivered over its power system 71,783,643 kilowatt hours of electrical energy (R. 8); that this included wholesale deliveries to other public utility companies, consisting of the delivery of 31,891,500 kilowatt hours to Northern Indiana Power Company and 5,795,720 to Attica Electric Company, leaving 34,096,423 kilowatt hours delivered by appellant to the so-called "gateways" of cities and towns served by it; that the average cost to appellant in 1928 of all electrical energy sold by it, excluding said wholesale interutility deliveries, and including allowance of 4 per cent per annum for depreciation and 8 per cent per annum for return on appellant's power system property, was $.024996 per kilowatt hour (R. 10) at the "gateways" of the cities and towns supplied by it; that appellant's local property used and useful in serving Martinsville has a value of not less than $141,520.38 (R. 11); that appellant in 1928 supplied its local Martinsville customers with 2,511,125 kilowatt hours of electrical energy; that taking this energy at the said average cost of $.024996 per kilowatt hour delivered at the Martinsville "gateway," adding 4 per cent per annum on the value of the Martinsville property to cover depreciation and adding the expense incurred by appellant in connection with the local distribution of the energy, the total cost to appellant of furnishing electrical service in Martinsville in 1928, without any allowance for return upon the local property, was $96,680.79; that the rates in effect in that year produced a revenue in Martinsville of $95,104.57, leaving an operating deficit of $1,575.32 (R. 11).

Answers.

March 14, 1929, the appellees filed an answer (R. 53-62). April 6, 1929, the city of Martinsville became a defendant by intervention and filed its answer (R. 63-71). The defendants denied that the rates were confiscatory.

Interlocutory Injunction.

On April 6, 1929, the District Court, three judges sitting, issued an interlocutory injunction restraining the enforcement of the rates complained of, on condition that if upon final hearing the rates should be permitted to become effective, appellant should refund to or credit the accounts of its customers respectively, at Martinsville, with any sums collected from them in excess of the rates in question (R. 71-2).

Hearing.

June 3, 1930, the District Court on its own motion referred the case to a special master in chancery to take and report the evidence with his findings of fact and conclusions of law (R. 72). The master took the evidence and reported it July 2, 1931, together with his special findings of fact and conclusions of law (R. 72-133). The master found the rates compensatory and recommended that the temporary injunction be dissolved and the bill be dismissed (R. 133). Appellant's exceptions were overruled by the court (R. 170) and the court entered its special findings of fact and conclusions of law (R. 156-170) in which it found the facts as stated by the master in his report to be true.

Final Decree.

The District Court on February 26, 1932, entered its final decree dissolving the temporary injunction and dismissing appellant's bill for want of equity (R. 170-1).

Opinion Below.

The opinion of the District Court appears in the printed record in this case (R. 142-156). The opinion has not been reported, but was published in the United States Daily of March 12, 1932.

Judisdiction of Court.

The appellant has filed its printed statement particularly disclosing the basis on which it is submitted that this court has jurisdiction to review on appeal the decree below.

Property Involved.

Appellant is a public utility corporation organized under the laws of Indiana. It owns and operates an electrical property used in supplying electrical energy for light, heat and power to approximately 18,000 individual customers residing in fifty cities, towns and rural communities (R. 202) in western Indiana (R. 75). The territory served by appellant lies in thirteen counties, namely, Sullivan, Greene, Owen, Clay, Vigo, Parke, Putnam, Morgan, Fountain, Warren, Tippecanoe, Vermillion and Montgomery (R. 159). Appellant's electrical property is a single physical and economic system, interconnected throughout, and all of appellant's customers are supplied from this one system. It consists generally of electric generating plants located at various points in the system, of high tension transmission lines, transformers, meters and other apparatus for the delivery of electrical energy over the territory generally, and of transformer substations, distribution lines, meters and other items of equipment for the distribution of the energy to appellant's urban, suburban and rural customers, the entire system being designed, installed and operated as an economic unit for the service of the area above indicated, without regard to municipal or other internal political boundary lines (R. 181, 184-186; 211, 226). Appellant generates only a very small part (less than one-fourth of one per cent) of the electrical energy delivered over its transmission system. The remainder (more than 99.75 per cent) it purchases. Its generat-

ing plants are used only to meet peak load demands of the system. A diagram map in evidence (R. 274) shows in green the location of appellant's high tension transmission lines, interconnecting its generating plants and local distribution systems. It also shows in different colors the high tension transmission lines of adjoining electric utilities with which appellant's system is interconnected.

Among the localities served by appellant with electrical energy is the city of Martinsville, the county seat of Morgan county, the residence of Mr. Singleton, chairman of the Public Service Commission of Indiana, one of the two commissioners who heard the case, and one of the three commissioners out of five who entered the order fixing the rates in question (R. 17, 53). His term has since expired and he was succeeded by Ralph M. Young who has been substituted as an appellee in lieu of Mr. Singleton. By the 1920 federal census Martinsville had a population of 4,895 which in 1930 had increased by 49 to 4,944.

Application to Public Service Commission.

On March 16, 1927, seventeen of appellant's Martinsville customers filed a petition with the Public Service Commission of Indiana asking for a reduction in electrical rates at Martinsville. The petitioners made no effort to relate the Martinsville rates in any way to the rates charged by appellant in the other portions of the area served by it and took no account of the effect which a change in the Martinsville rates might have on the revenue derived by appellant from the service rendered by it in the area as a whole. The commission conducted a hearing and on January 26, 1929, entered its order No. 8894 (R. 15-53) reducing appellant's rates for electrical energy supplied to Martinsville customers, effective on bills rendered by

appellant after February 1, 1929. Appellant filed its petition with the commission for a rehearing, which was denied. Appellant's Martinsville revenue for the year 1929 was $100,269.56 (Ex. 107, R. 313, covering January; Ex. 113, R. 319, covering February to December). The rates ordered by the commission would have reduced this revenue by $14,836.57. The reduction in rates ordered was accordingly 14.79 per cent (R. 264, 265).

The Commission's Order.

The commission in its order ignored the interconnected and interdependent character of appellant's property and the area to the service of which the property is devoted, and dealt with the case by dismembering the property and considering only that portion located at Martinsville, to which it assigned a value of $87,000 (R. 45). All of the energy supplied by appellant in Martinsville, is delivered to that community by appellant over its transmission lines from outside sources. The commission nevertheless refused to consider as useful in serving Martinsville any of appellant's property except the local property in that community and made no valuation except of the local property. Instead, it found that $.0172 was a fair price per kilowatt hour for energy delivered by appellant at its Martinsville substation for local distribution, which point the commission called the "gateway" (R. 34-46). It reached this price by the process of dividing $719,175 (the total cost to appellant in 1927 of purchased power) by 51,457,770 (the kilowatt hours of energy purchased by appellant in that year) which gave a figure of $.0139 per kilowatt hour (R. 43-44). To this the commission added an arbitrary figure of $.0033 per kilowatt hour to cover return on appellant's "power system" property used in delivering energy to the Martinsville substation, thereby getting the

figure of $.0172 above mentioned. How the figure of $.0033 was arrived at is nowhere indicated. It was not based upon a valuation of the power system property, for the commission made no such valuation. On the contrary, it stated that it was not necessary to value any property except the local Martinsville property. The commission, also, refused to make any allowance to cover the expense of depreciation on appellant's power system property (R. 41), giving the strange reason that appellant had outstanding a corporate mortgage which required it to set aside 12½ per cent of its gross revenue to be used for meeting depreciation (R. 46). How this clause in the mortgage was expected to produce any revenue is not explained by the order. With equal lack of grasp of the problem, it refused to make any allowance, in valuing the property, for working capital (R. 41-43) stating that by an order No. 7018 entered June 26, 1923, it had previously granted appellant the right to issue stock to provide working capital (R. 42). With equal logic it might have denied the right to earn a return on all the property upon the ground that it had previously authorized the securities with the proceeds of which appellant's property was acquired. Nevertheless, it stated in its order that the "gateway" cost of $.0172 per kilowatt hour included production cost, depreciation and return (R. 45-46).

The Master's Findings.

The master found (F. 49, R. 132) that the rate base for Martinsville should consist of the Martinsville local property, which he valued at $102,947 (R. 94), plus a proportionate part of appellant's power system to be allocated to Martinsville. He valued the power system property at $3,066,395 (R. 98-99) and allocated 3.3 per cent of it, *i. e.*, $101,191 to the use of Martinsville (R. 108, 109), mak-

ing a total sum of $204,138 for the Martinsville rate base. He reached this percentage (3.3 per cent) by an approximation based on (a) the ratio of kilowatt hours of electrical energy sold by appellant to Martinsville customers for the year 1929, to the kilowatt hours of electrical energy sold by appellant during the year, 1929, including deliveries to affiliated utilities; (b) the ratio of Martinsville substation output for 1929 to the total output of all substations of appellant for the year 1929; and (c) the ratio of Martinsville peak demand in 1929 to appellant's system peak demand in the same year, but occurring on different days of the year (R. 109).

The rate base so fixed by the master was used by him to determine the amount of depreciation to be charged as an expense and the amount to be allowed as a return to plaintiff on account of property used in serving Martinsville.

The master accepted the local distribution expenses for Martinsville as actually incurred by appellant, except as to the items of rate case expense and of cost of electrical energy. The rate case had been pending nearly two years before the commission and more than a year before the court. The evidence showed without dispute that appellant had incurred an expense of more than $60,000 in connection with it. The master excluded all of this expense, except $4,000 which he found should be amortized by the making of an operating charge of $400 a year for ten years (R. 116). This action was arbitrary, being without any basis in the evidence.

The master found that $.018 per kilowatt hour was a reasonable price for electrical energy delivered by appellant at its Martinsville substation for local distribution (F. No. 44, R. 127-128). He reached this price by finding the total cost to appellant of power for its entire interconnected

system (exclusive of any allowance for depreciation or for return) and finding the amount equal to that proportion of such cost which the quantity of electrical energy delivered to the Martinsville substation bore to the total energy delivered in appellant's interconnected system, and dividing this amount by the number of kilowatt hours of energy delivered to Martinsville. He went through this process for the three years 1927, 1928 and 1929 and then took an average for the three years, reaching a figure of $.0138 per kilowatt hour (R. 127). He then allowed 4 per cent per annum for depreciation on the depreciable portion of appellant's power system property, which portion he valued at $2,569,395 and 7 per cent per annum for return on the entire power system property, which he valued at $3,066,395 (R. 128). On this basis he arrived at $.0042 per kilowatt hour to cover depreciation and return, upon the basis of a total 75,811,628 kilowatt hour delivery during 1929 throughout all of appellant's interconnected system—thus averaging all of appellant's interutility and wholesale deliveries with its deliveries to its retail customers on a flat kilowatt hour basis.

The Court's Findings.

The District Court overruled the exceptions taken by appellant to the findings of the master (R. 170) and found that the facts found by him are true (R. 169). It also made and filed its special findings of fact and conclusions of law (R. 156-170). Following the master's recommendation, it separated Martinsville from the remainder of appellant's property and determined the rate base to be the Martinsville local property, plus an apportionable part of the interconnected power system property. It determined the rate base by employing the same method used by the master and fixed the same value as the master, namely, $102,947,

for the Martinsville local property (R. 162-163), plus $101,191 for the apportionable part of the power system (R. 167) or a total of $204,138 for the Martinsville rate base.

The court found the cost of electrical energy delivered at the Martinsville substation for local distribution in Martinsville to be $.0133 per kilowatt hour (R. 168). The cost was determined by taking the average for the entire interconnected system for 1929 (Ex. 107, R. 310, 311). It includes the purchase price of one cent per kilowatt hour paid by appellant to Indiana Electric Corporation, another electrical utility corporation from whom appellant purchases substantially all of its electrical energy, and all other power system expenses, except an annual allowance for depreciation expense and return (R. 127). On this basis the court tested the rates at Martinsville for the calendar year 1929 (R. 168, 169) and for the year ending May 31, 1930 (R. 168) and found them compensatory.

The Evidence.

Appellant's electrical property is shown without dispute to constitute one single physical and economic operating unit, interconnected throughout and used to supply electrical energy to the public residing in fifty towns, cities and rural communities located on that system in the above named thirteen counties in western Indiana (R. 73-75; 78-81; 159; 180-193). Every portion of this property, of whatever description or wherever located, is in use and is useful for furnishing service to that public to the same extent that an interconnected electrical property within a single political subdivision is used and useful as a whole in serving each neighborhood in the area (R. 186). Appellant's Martinsville property has no separate physi-

cal existence from an operating or economic standpoint, the energy flowing into and through that portion of the property being utterly indistinguishable and indivisible from the energy constantly flowing into and through the system as a whole (R. 184-185, 207).

Appellant and six other Indiana utility corporations, namely, Indiana Electric Corporation, Northern Indiana Power Company, Attica Electric Company, Colfax Electric Company, Moran Electric Light and Power Company and Mulberry Light and Power Company serve the public with electrical energy in certain territory in central, western and northern Indiana shown on the diagram map (R. 274). The stocks and bonds of these seven companies are owned by Central Indiana Power Company. The seven companies are referred to in the record as "affiliated companies." They have common officers and a common management and their electrical transmission lines are physically interconnected for the interchange among them of electrical energy to serve the public supplied by each respectively.

Appellant owns three small electrical generating plants located in the cities of Martinsville, Sullivan and Clinton, built by former owners for supplying energy locally in the cities where located. They are no longer used for local service but are maintained as reserve plants and used to supply a relatively small amount of energy to the interconnected system during the peak load period (R. 182; 191, 192). The master found they were used and useful property in supplying the system and that their fair value was $309,388 (R. 102).

Appellant purchases practically all of the energy it supplies its customers from Indiana Electric Corporation. The electrical energy generated and purchased by appel-

lant is shown by Exhibits 16 and 17 (R. 279), Exhibit 107 (R. 310) and Exhibit 111 (R. 316) and is as follows:

	K. W. H. Generated	% of Total	K. W. H. Purchased	% of Total	Total K. W. H.
1927	112,700	.19	58,374,349	99.81	58,487,049
1928	177,680	.22	80,275,803	99.78	80,453,483
1929	123,470	.15	84,136,922	99.85	84,260,392
1930—year ending May 31	77,945	.09	85,217,894	99.91	85,295,839

The source of the electrical energy purchased by appellant is shown by Exhibits 107 (R. 310) and 111 (R. 316) to be:

	K. W. H. purchased from Indiana Electric Corp.	% of Total	K. W. H. purchased from Nor. Ind. Power Co.	% of Total	K. W. H. purchased from utilities not affiliated	% of Total	Total K. W. H. purchased
1927	57,684,897	98.82	345,600	.592	343,852	.592	58,374,349
1928	79,962,702	99.61	None		313,101	.39	80,275,803
1929	83,781,646	99.58	None		355,276	.42	84,136,922

The interconnected system owned by appellant and used by it to serve the public in its territory was planned and built about 1923 (R. 180-181); prior to that time small independent companies generated electricity in small plants located in the communities served. At first there was no interconnection between the generating plants in the different communities and a great many municipal corporations, coal mines and other industries operated their own plants. The practice began to change with the increase in the industrial load, and many municipalities, coal mines

and other industries abandoned the practice of generating their own current and commenced buying electrical energy from central generating stations. With the growth of the industrial load, generating plants were interconnected to provide a more reliable and dependable supply of electrical energy and to save investment in reserve generating equipment. With the improvement in the art of generating and transmitting electricity it became apparent shortly prior to 1923 that to generate and supply electrical energy most economically a larger generating station should be built than was required by any one of the affiliated companies. Accordingly the management of appellant conceived the plan of building a generating plant large enough to supply the combined load of all of the affiliated companies. A survey of the territory was made in 1921 and 1922 and it was found that the nearest location where sufficient condensing water could be obtained to operate a large electrical generating station was either on the Ohio River or the Wabash River (R. 181). Options were secured on properties and the affiliated companies purchased certain local properties for the purpose of getting together a group of properties with a sufficient electrical load to make commercially expedient the building of the contemplated power plant on the Wabash River (R. 181). The first purchase of properties by appellant to this end was approved by the Public Service Commission of Indiana on June 26, 1923, as appears from order No. 7018 of the Commission, Exhibit 19-A (R. 281-283). In this purchase was included the Martinsville property.

Indiana Electric Corporation proceeded to construct a large generating plant on the Wabash River near Terre Haute, Indiana, known as the Dresser Plant, with a capacity of 60,000 kilowatts capable of supplying 300,000,000 kilowatt hours per year (R. 80). None of the affiliated companies required enough electricity to make it possible

to build or operate the Dresser Plant and it was necessary that the Dresser Plant serve the customers of all of the affiliated companies in order that it would be commercially expedient to construct it (R. 181, 188). For example, in 1929 there was delivered over appellant's interconnected system a total of 75,811,628 kilowatt hours (R. 313, at p. 91 of Ex. 107), and deducting from this 37,618,964 kilowatt hours delivered to affiliated utilities (R. 313, at p. 84 of Ex. 107) leaves an aggregate of 38,192,664 kilowatt hours delivered by appellant to its customers on its system. Thus by 1929 appellant's requirements for its customers were only about 12½ per cent of the capacity of the Dresser Plant (R. 80). The affiliated companies each built transmission lines in their respective territories interconnecting their various towns and cities. They also physically connected their lines with each other for the interchange of energy and the securing of the supply from the Dresser Plant.

An examination of the map (R. 274) shows that the transmission lines of the companies are so connected as to form a major loop which may be described as follows: From Terre Haute northeasterly to the Lenore substation south of Indianapolis, owned by Indiana Electric Corporation; From the Lenore substation northerly to Kokomo, and from Kokomo westerly to Lafayette, owned by Northern Indiana Power Company; From Lafayette southwesterly to Attica, and from Attica southerly to Clinton, owned by appellant; From Clinton southerly to Terre Haute, owned by Indiana Electric Corporation. This loop is of great value in supplying reliable and dependable service, for the simple reason that if there should be a break in the line at any point, the supply of energy to the towns beyond the break is not interrupted but it continues to flow in from the other side of the loop. Other smaller transmission loops are disclosed on the map as are connections for reserve and emergency supplies of energy

from the generating plants of companies other than the affiliated companies. Each of the affiliated companies built the necessary transmission lines in its respective territory.

Since the organization and construction of appellant's interconnected system in 1923, it has made over 100 rate reductions (R 192). Appellant has established and maintained uniform rates for the same classes of service in cities, towns and communities of the same class (R. 192). All of these rates have been approved by the Public Service Commission of Indiana.

The Dresser Plant is situated near the southwesterly corner of the territory served by the seven affiliated companies. It is seen from the map that the territory served by appellant lies between the Dresser Plant and the territory to the north and northeast, which is served by Attica Electric Company and Northern Indiana Power Company. Consequently Northern Indiana Power Company and Attica Electric Company draw electrical energy generated at the Dresser Plant over the 66 K. V. transmission line of appellant which extends northerly from Clinton to Attica and northeasterly from Attica to Lafayette. A small amount of energy is interchanged between utilities at other points. About 50 per cent of the annual deliveries of energy by appellant over its transmission lines are made in bulk to affiliated utilities. The electrical energy delivered by appellant is shown by Exhibits 107 (R. 310-311) and 111 (R. 315-316) to be:

	K. W. H. delivered to affiliated utilities	% of Total	K. W. H. delivered to Martinsville	% of Total	K. W. H. delivered to other customers	% of Total	Total K. W. H.
1927	22,044,144	42.6	2,219,144	4.28	27,480,332	53.12	51,743,620
1928	38,465,270	53.58	2,426,344	3.38	30,892,030	43.04	71,783,644
1929	37,618,964	49.62	2,532,798	3.34	35,659,866	47.04	75,811,628

Eliminating deliveries of electrical energy to affiliated companies, the deliveries to appellant's customers are shown to be:

	K. W. H. delivered to Martinsville	% of Total	K. W. H. delivered to other customers	% of Total	Total K. W. H.
1927	2,219,144	7.47	27,480,332	92.53	29,699,476
1928	2,426,344	7.28	30,892,030	92.72	33,318,374
1929	2,532,798	6.63	35,659,866	93.37	38,192,664

Over 50 per cent of the electrical energy sold by appellant to its own customers (after first excluding the deliveries to affiliated utilities above mentioned) is supplied to coal mines and other industries outside of the municipal boundaries of cities and towns (R. 181).

The electrical energy delivered by appellant to affiliated companies is shown by Exhibits 107 (R. 313) and 111 (R. 316) to be divided as follows:

	K. W. H. to Northern Ind. P. Co.	K. W. H. to Attica Electric Co.	K. W. H. to Indiana El. Corporation	K. W. H. to utilities not affiliated	Total K. W. H.
1927	15,666,974	4,682,590	1,678,980	15,600	22,044,144
1928	31,891,500	5,795,720	778,050	None	38,465,270
1929	30,239,200	6,014,822	1,364,942	None	37,618,964

The economic advantage of a large generating station over a small local plant was conceded by appellees (R. 79). It was admitted that electrical energy can be generated in a large plant and delivered by an interconnected transmission system, such as appellant operates, more cheaply than it can be generated locally for a city such as Martinsville (R. 268), and that Martinsville must purchase electrical energy from a system such as appellant's in order to secure low rates (R. 261).

Appellant buys electrical energy generated at the Dresser Plant from Indiana Electric Corporation for one cent per kilowatt hour delivered at the Clinton, Indiana, substation. Appellant transmits this energy about 90 miles to its Martinsville substation and there offers it for local distribution in Martinsville at a cost of $.024996 per kilowatt hour (p. 4, Ex. 21, R. 289). If appellant should physically separate Martinsville from its interconnected system property and generate electrical energy in a small local generating plant designed to supply Martinsville alone, the electrical energy supplied at the substation for local distribution would cost from $.028958 (testimony of Charles A. Hamilton, R. 216-218, Ex. 6, R. 277) to $.03712 per kilowatt hour (testimony of Carl J. Sittinger, R. 223-228, Ex. 9, R. 278; testimony of F. W. Martin, R. 214-216, Ex. 5, R. 276), showing a saving of not less than $.004 per kilowatt hour in favor of appellant's plan of service over the cost in a local plant. Appellees' witness, Roy Husselman, testified to extreme estimated electric generating costs ranging from $.0188136 per kilowatt hour in a Diesel engine plant (Ex. 127, R. 321) to $.466 per kilowatt hour in appellant's local Martinsville plant (Ex. 130, R. 321, 322). But Husselman conceded that a large interconnected system could purchase and deliver energy at Martinsville for local distribution cheaper than it could be generated locally (R. 267). The economic advantage of an interconnected electrical system like that of appellant to the various communities located within the general area covered, and particularly to the community of Martinsville, thus is not in dispute.

Value of Property.

Appellant offered appraisals of the value of its entire electrical property by the engineering firm of Spooner & Merrill, represented by Charles W. Spooner and Donald M. Cook, and a like appraisal of the same property by the engineering firm of Stone & Webster, represented by William P. Burnell and Charles J. Sittinger, all of whom testified. Both appraisals were complete and covered appellant's entire electrical property. Summarized their appraisals were as follows:

	Stone & Webster Exhibit 7, (R. 277)		Spooner & Merrill Exhibit 2-G, (R. 275)	
	New	Depreciated	New	Depreciated
Cost of Reproduction with additions to May 1, 1930, May 1, 1929 prices	$4,825,138	$4,718,507	$4,794,359	$4,351,752
Less land (R. 303)	10,388		10,388	10,388
Depreciable Base	$4,814,750		$4,783,971	$4,341,364
Organization		100,000		
Working Cash		40,000		163,000
Materials and Supplies		160,000		140,000
Cost of Financing		270,000		182,185
Going Value		540,000		719,154
		$5,828,507		$5,556,091

The original cost of the plant and property on April 30, 1930, as shown by appellant's books, was $5,235,900.94, of which $4,940,686.94 was electric utility property (R. 232, Ex. 19, R. 280), not including working capital, materials and supplies. All of appellant's outstanding securities, with the proceeds of which it acquired this property (R. 281), were authorized by the Public Service Commission of Indiana by orders entered during the years 1923 to 1927 (R. 281-287). The total of these securities was $5,088,100 (R. 232).

Appellees offered as witnesses Harry V. Wenger and Hugh W. Abbett, members of the engineering staff of the Public Service Commission of Indiana, and Roy Husselman of Cleveland, Ohio, a consulting engineer, none of whom made any appraisal of appellant's electrical property as a whole.

The master ignored entirely the appraisal of Stone & Webster (R. 86). The Spooner & Merrill appraisal showed a value for appellant's local property in Martinsville, after an allowance for accrued depreciation, of $135,402 (R. 275). The witness Abbett appraised the same property at $83,000 (R. 308). The master rejected the appraisal of Spooner & Merrill and accepted that of Abbett (R. 94, F. 19), except as to minor items, and found a value of $102,947. Finding that the figure so accepted by him represented 82.7 per cent of the value of the local Martinsville property as found by Spooner & Merrill, he arbitrarily applied this percentage to the Spooner & Merrill appraisal of appellant's electrical property as a whole and on this basis made a finding that the value of such property was $4,594,887 (R. 130, F. 47). No witness testified to any such figure. The finding is without support of any kind in the evidence.

The income from and expense of appellant's whole property for the year ending May 31, 1930, is shown at page 11 of Exhibit 22 (R. 295) to be:

Gross Income	$1,741,308.40
Operating expenses and taxes	1,303,875.72
Net income	$ 437,432.68
Depreciation at 4% on depreciable property of $4,341,364, which is $4,351,752 (R. 275), less land valued at $10,388 (R. 303)	173,654.56
Balance for return year ending May 31, 1930	$ 263,778.12

This is a return of 4.72 per cent on the appraisal of $5,556,091 by Spooner & Merrill. It is a return of 4.52 per cent on the appraisal of $5,828,507 by Stone & Webster. It is a return of 5.74 per cent on the finding of a fair value of $4,594,887 by the master. The master in his finding of fair value (R. 130-131, F. 47) found that appellant earned a return of only 4.15 per cent on its property as a whole for the year 1929.

In approving the master's finding (based merely on the ratio of deliveries of electricity in Martinsville to the deliveries over appellant's entire system), that 3.3 per cent of appellant's power system property should be regarded as useful in serving Martinsville (R. 151-167) the court gave no consideration to the actual uses to which the property is shown by the evidence to be put. The evidence shows without dispute that had the court, instead of merely averaging all kilowatt hour deliveries together without regard to their character, first excluded interutility de-

liveries [which are made at wholesale rates under interchange arrangements whereby appellant in case of necessity can receive power when needed (R. 183 and 316)] and taken a ratio based upon deliveries of energy to Martinsville customers as compared with deliveries to all other customers, it would have arrived at 6.63 per cent as the portion of the power system applicable to Martinsville, instead of 3.3 per cent.

The following tables will show how the court found the value of the several parts of the appellant's property as compared with the appraisals in evidence:

	Spooner & Merrill Exhibit 2-I (R. 275 & 276) New	Depreciated	Pu
Structural cost September 1, 1929, with May 1, 1929 prices	$2,116,277	$	$2
Total structural overheads	338,612		
Additions and Betterments			
Stone & Webster and Spooner & Merrill to May 1, 1930— Public Service Commission of Indiana to January 1, 1930	539,065	539,065	
Total property	$2,993,954	$2,837,237	$2
Less land (R. 295)	7,188	7,188	
Total depreciable property	$2,986,766	$2,830,049	$2
Feeder allocated to Power System		1,149	
Working Cash		127,352	
Materials and Supplies		90,000	
Organization			
Cost of financing		117,620	
Going value		464,292	
Total Rate Base		$3,637,650	
Deduction for reduced copper prices to 9-1-30			

(A) Exhibit 104 (R. 309)—Working cash, materials and supplies

(B) Exhibit 104 (R. 309)—Going value

NOTE: Stone & Webster included the Power System Property in the sa property at unit costs approximately 5% higher than those

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POWER SYSTEM PROPERTY

	ner & Merrill 2-I (R. 275 & 276)		Public Service Commission Exhibit 103 (R. 308)— Exhibit 104 (R. 309)		Husselman Exhibit 132, (R. 322 & 323)		Master Master's Finding 22; (R. 99, 130)	
	Depreciated		New	Depreciated	New	Depreciated	New	Depreciated
77	$		$2,138,001	$1,765,530	$1,655,329	$1,481,166	$2,138,001	$1,765,530
12			295,476	286,764	240,399	215,157	320,700	264,800
55		539,065	490,051	490,051	497,655	497,655	539,065	539,065
54		$2,837,237	$2,923,528	$2,542,345	$2,393,383	$2,193,978	$2,997,766	$2,569,395
38		7,188	7,188					
56		$2,830,049	$2,916,340	$	$	$		
		1,149						
		127,352		(A) 103,727		18,915		80,000
		90,000				71,037		167,000
						30,616		
		117,620						
—		464,292		(B) 222,294		19,974		250,000
		$3,637,650		$2,868,366		$2,334,520		$3,066,395
					132,828	124,858		
						$2,209,662	Master's finding approved by court (R. 164)	

als and supplies

em Property in the appraisal of the entire electric
% higher than those of Spooner & Merrill.

	Spooner & Merrill Exhibit 2-H; (R. 275)		Stone & Webste Exhibit 8; (R. 27	
	New	Depreciated	New	Depreci
Distribution System	$84,901	$74,492	$85,953	$84,41
Property in Power Plant used only for Martinsville service	12,475	10,936		
General Equipment allocated to Martinsville	5,412	4,530		
Structural Overheads:				
Omissions & Contingencies			4,200	4,20
Engineering costs			1,300	1,30
Law Expense				
Miscellaneous construction expenditures			(B) 1,700	1,70
Taxes during construction				
Interest during construction			4,800	4,80
Superintendence of construction			700	70
Total Overheads	$10,964	$10,701	$12,700	$12,70
Less Land (R. 294)		376		37
Total Depreciable Property		$100,283		$ 96,74
Total Structural Costs and Overheads	$113,752	$100,659	$98,653	$ 97,11
Working Cash		5,358		(A) 4,10
Material & Supplies		10,000		
Organization and Expense				
Cost of Financing		4,322		5,60
Going Value		17,063		11,00
Total (Rate Base)	$	$135,402	$	$119,81
Deduct to adjust price of copper from 5/1/30 to 9/1/30				
Remainder				

(A) Includes both cash and materials and supplies
(B) Includes law expenses
(C) Called administration and legal expenses in Exhibit 100; (R. 307)

LE LOCAL ELECTRIC PROPERTY

	& Webster t 8; (R. 278) Depreciated	Commission Staff Exhibit 100; (R. 307) Exhibit 101; (R. 300) New	Depreciated	Husselman Exhibit 131; (R. 322) New	Depreciated	Master Master's Finding 19; (R. 94) New	Depreciated
3	$84,418	$70,104	$58,932	$70,104	$58,932	$70,104	$58,932
						12,475	10,936
		5,294	4,020	5,294	4,020	5,294	4,020
0	4,200	1,058	883	1,058	883		
0	1,300	3,609	3,013	3,609	3,013		
		191	159	191	159		
0	1,700	384	321	384	321		
		593	495	202	169		
0	4,800	2,883	2,407	938	783		
0	700	1,221	1,019	1,221	1,019		
0	$12,700	$ 9,939	$ 8,297	$ 7,603	$ 6,347	$10,964	$10,701
	376						
	$ 96,742						
3	$ 97,118	$85,337	$71,249	$83,001	$69,299		
	(A) 4,100				3,200		$ 3,358
		2,968	2,968		3,320		6,500
		(C) 1,508	1,508				
	5,600						
	11,000		7,275		5,308		8,500
	$119,818	$	$83,000	$	$81,127		$102,947
				1,552	1,397	Master's finding approved by court (R. 163)	
					$79,730		

(R. 307)

The court reached this result by accepting (R. 94, 100) the opinion of the witness Abbett (R. 242) as to the principal items of property. On a few minor items where his value was obviously indefensible the opinion of Spooner & Merrill was adopted. The appellant offered the testimony of Charles W. Spooner (R. 195); Donald M. Cook (R. 208); William V. Burnell (R. 218), and Carl J. Sittinger (R. 223) appraisal engineers of wide experience. The court in the main brushed appellant's evidence aside and accepted the opinion of the witness Abbett. The court accepted the opinion as to value, of one man and rejected the opinion of four men of much greater experience. The book value, capitalization, earnings and orders of the Public Service Commission of Indiana authorizing securities, support the opinion of appellant's witnesses. There is only very slight corroboration of Abbett in the testimony of Wenger (R. 261) and Husselman (R. 266).

Without reflecting on Mr. Abbett it is only stating the necessary fact to say that he is a young man of slight experience as compared with the four witnesses produced by appellant (R. 243, 252). He graduated from Purdue University as an engineer in 1916, watched switches a short time in a plant of the Indianapolis Light and Heat Company, went into the army, taught school, and in 1919 became an assistant to the engineering staff of the Publice Service Commission of Indiana, which position he still holds. During his connection with the commission he has been connected with about one hundred appraisals of utility property (R. 243). He has had no construction experience, except in school, and his opinion on prices is based on catalogs and quotations, and his opinion on labor performances on mathematical calculations.

The appellant's witnesses are men known and generally recognized as engineers of standing and ability. Messrs.

Spooner and Cook are graduates of the engineering school of the University of Michigan. Mr. Spooner (R. 195-197) has had practical experience as an electrical engineer since 1906 and Mr. Cook (R. 208) since 1915. They have both been acquainted with appellant's property for the last ten years. Both have made many appraisals of utility properties for rate cases, security issues, bank loans and purchasers. Witnesses Burnell (R. 218) and Sittinger (R. 223) of the Stone & Webster Engineering Corporation are two of the best qualified and best known appraisal engineers in the country. The master disregarded their testimony altogether (R. 85, 86). Burnell graduated in 1904 and has been actively engaged since then in engineering work. Sittinger has had over 20 years experience. The Stone & Webster organization is known by reputation throughout the world. The offhand way in which the master disposed of their evidence and disregarded their years of experience is sufficient to discredit his finding.

Cost of Financing.

The witness Pennington (R. 193) engaged in marketing utility securities during the last eight years, testified that the selling cost of appellant's preferred stock would be from 5 to 10 per cent of the par value. The witness Kelley (R. 194), engaged in marketing utility securities during the last five years, testified that the selling cost of appellant's bonds would be from 4 to 5 per cent. The witness Cook (R. 210) testified that he arrived at the cost of financing by using the figures of Mr. Pennington and Mr. Kelley which, by arithmetical calculation, is an average of 3.8 per cent on the securities as a whole. He testified that he included nothing for cost of financing the common stock. The witness Burnell (R. 220)

testified that he placed the cost of financing, at a conservative estimate, at five per cent. The court disregarded all of this evidence and allowed nothing for the cost of financing (R. 164).

Rate Case Expense.

The actual expense of this rate case exceeded $60,000 (R. 237), but the commission ordered that the expense of the rate case charged to Martinsville be amortized at not over $400 a year over a period of ten years (R. 52). By the same order the commission ordered appellant to pay $1,000 costs for the appraisal by the commission of appellant's local property at Martinsville (R. 52). The commission by this order appraised appellant's local Martinsville property at $87,000 (R. 45). The master (R. 116) and the court (R. 168) concurred with the commission in holding $400 per year for ten years a sufficient allowance to appellant on account of expenses incurred by virtue of this rate inquiry. The court allowed the master $4,500 for taking and reporting the evidence with his findings and conclusions (R. 142). Appellant is thus left in the position of being obligated by the order of the commission to pay to that body $1,000 for its appraisal of the local Martinsville property and obligated by the order of the court to pay into the latter $4,500 for master's fees, or an aggregate of $5,500, while being permitted by the order of the court to earn only $4,000, over a ten year period, with which to make the payment. The court made no provision for the earning by appellant of the money with which to pay for the other expenses actually incurred by it in connection with the case, in the making of inventories, appraisals, etc. Under the findings both of the master and the court (R. 99, 164) the appraisal of the power system was necessary, the value found being $3,366,395. The

testimony of appellant's witness, Louis Schiesz, that the actual expenses incurred by appellant in the case to October 1, 1930, were approximately $60,000 is not questioned or disputed (R. 237). Exhibit 111 (R. 317) shows itemized expenses in 1927 and 1928 of $25,972.64, and Exhibit 107 (R. 313, 314) shows expenses of $19,760.62 in 1929, a total of $45,733.26.

Rate of Return.

The court held 7 per cent sufficient (R. 168). Appellant claimed not less than 8 per cent should be allowed (R. 139, 178).

Appellees' witnesses Abbett (R. 250), Wenger (R. 263), Husselman (R. 267) and Carter (R. 273) testified that 7 per cent per annum would be a fair rate of return on the property and 4 per cent would be a fair amount for depreciation. These witnesses did not make any allowance for the accumulation of a surplus. Appellant's witness Spooner (R. 207) testified that it is necessary to have a rate of return of 7 per cent per annum to take care of bond interest, debt discount, borrowed money and stock dividends, and that to accumulate a surplus the rate of return should be not less than 8 per cent based on the fair value determined for rate making purposes. The appellant's witnesses Burnell (R. 221) Sittinger (R. 227) and Schiesz (R. 235) testified that 8 per cent was a fair return to enable the utility to live and continue to operate.

Specification of Errors Urged.

Appellant urges all the errors assigned (R. 172-R. 179). The errors may be briefly summarized as follows:

1. The court erred in holding that in testing the rates complained of, appellant's Martinsville property should

be considered as a segregated unit and separated from the remainder of the operating unit of which it is an integral physical and economic part (R. 173-R. 174).

2. If in fixing a rate base, segregating appellant's Martinsville property from the remainder of appellant's electrical system was not error, nevertheless the court erred because (a) it did not make a proper allocation of the property outside Martinsville used and useful in serving Martinsville, and (b) it did not properly determine the cost of electrical energy delivered at the Martinsville substation for distribution to Martinsville customers (R. 174-176).

3. The court erred in finding the value of appellant's used and useful property (R. 176, 178).

4. The court erred in allowing only $4,000 to be charged to operating expense for the expense of this rate case, when the actual expense of this case was proven to be in excess of $60,000 (R. 116, 168, 178).

5. The court erred in holding that a 7 per cent return was reasonable when in fact a return of not less than 8 per cent should have been allowed to prevent confiscation (R. 118, 119, 168, 178).

6. The court erred in holding that the rates complained of would have yielded a fair rate of return when in fact the rate of return would be less than fair and reasonable, and would not exceed 5 per cent (R. 124-129; 178).

7. The court erred in holding that the rates complained of are not confiscatory, and in dismissing appellant's bill for want of equity, and in not enjoining the enforcement of the said rates, because said rates are confiscatory and deprive appellant of its property without due process of law, contrary to the Fourteenth Amendment to the Constitution of the United States (R. 141, 178).

ARGUMENT.

I.

The Operating Unit Is the Rate Base

First Assignment of Error (R. 173 & 174).

The court erred in holding that in fixing a rate base appellant's Martinsville property should be considered as a segregated unit and separated from the remainder of the operating unit of which it is an integral physical and economic part (R. 110, 132 and 162).

Appellant contends that its operating property as a unit, not some theoretical and shifting portion of that property, is the proper base for the determination of rates for the area served by that operating property or for any neighborhood or locality within that area; that the guiding constitutional principle which must be observed is that no reduction in rates for the area as a whole or for any part of it may be imposed by public authority unless the earnings of the entire property after such reduction shall be sufficient to yield a fair return upon that property as a whole.

The evidence is undisputed that appellant's electrical system as a unit is making less than a fair return on the value of the used and useful property which composes it. Even the master, after he had arbitrarily reduced the value of the property to 82.7% of the Spooner & Merrill appraisal, was obliged to concede that the return earned by appellant's entire electrical property for the year 1929 did not exceed 4.15% (R. 131).

The appraisal by Spooner & Merrill of the property as a whole (R. 275) shows a valuation of $5,556,091.00. No witness appraised it at less than this amount and there is no basis in the evidence for valuing it at less. On page 11 of Exhibit 22 (R. 295) appears the income and expense for the year ending May 31, 1930. A summary thereof shows the following results:

BALANCE AVAILABLE FOR RETURN—
YEAR ENDED MAY 31, 1930
Page 11; Exhibit 22 (R. 295)

Gross Revenue, System, including revenue from Northern Indiana and Attica Electric Company, adjusted to rate of 1¼c per K. W. H.	$1,741,308.40	
Less:		
Operating expenses and taxes	1,303,875.72	
Net income		$437,432.68
Depreciation at 4% on depreciable property of $4,341,364, which is $4,351,752 (R. 275), less land valued at $10,388 (R. 303)	173,654.56	
Balance available for return		$263,778.12

This is a return of:
4.74% on $5,556,091, appraisal of Spooner & Merrill
4.52% on $5,828,507, appraisal of Stone & Webster
5.73% on $4,594,887, value found by Master.

It is, therefore, indisputable that if the used and useful property constituting the operating unit is to be used as the rate base, the rates in question are confiscatory.

The facts relative to the history, development, construction and operation of appellant's property have been stated. It is obvious on this record that appellant's electrical property constitutes and is in fact one single physical and economical operating unit interconnected and interdependent throughout and used to supply electrical energy to the public residing in fifty communities located on that system in a definite area in western Indiana (R. 73-75; 78-81; 157-160). Every part of appellant's electrical property is used in supplying service to this public which it serves. It is one electrical operating unit, one public service, one utility, not fifty. To assert the contrary is to ignore the fact.

The commission approved the purchase by appellant of the Martinsville property on June 26, 1923 (Exhibit 19-a, R. 281-283). This purchase was part of a plan conceived by the management of the affiliated companies. The management of the affiliated companies made surveys in 1921 and 1922 of the territory near Indianapolis and found that the nearest adequate supply of water for an electrical generating station was either the Ohio River or the Wabash River.

In earlier years electricity was generated in small isolated generating plants located in the communities served. Each municipality or community was in those days a separate unit in itself. There were no interconnections between generating plants in different communities. In case of breakdowns from storm or other causes the service was interrupted. The economies of large generating stations favorably located were unknown and there was no such

thing as rural electrical service. This practice changed as the industrial load increased and as the technical art developed. Demands for energy became so great that it was no longer possible to supply them economically with small generating plants. From 600 to 700 tons of condensing water are required for each ton of coal burned in a generating plant. It is apparent that a large plant can be constructed only on a large body or flow of water. The accepted method of furnishing electrical energy has changed until it has become the general practice, accepted and approved by substantially all electrical engineers, to locate and build very large generating plants where large supplies of water and fuel are cheaply and certainly available, and then to transmit the electricity over high voltage lines to the ultimate consumers residing over large areas. The economic principles which underlie this development are compelling and have nothing to do with the political boundaries of municipal corporations.

In conformity with this accepted and recognized plan of generating, transmitting and distributing electricity, the Dresser plant was built in the midst of the coal fields on the Wabash River near Terre Haute, Indiana, by the Indiana Electric Corporation.

In order to finance the Dresser plant it was necessary to assemble a group of electrical properties with a sufficient demand for electrical energy and income to make the project commercially expedient. Accordingly, the affiliated companies purchased and acquired properties which were interconnected. The aggregate requirements of the affiliated companies were comparable to the capacity of the Dresser plant and sufficient to permit its economical operation. Among these affiliated corporations were the Wabash Valley Electric Company, appellant herein; Indiana Electric Corporation, builder of the Dresser plant;

Northern Indiana Power Company and Attica Electric Company. The four named were the principal ones, the smaller ones being of little importance, but all are shown on the diagram map in evidence (R. 274). The lines of the respective companies are shown in different colors. In addition foreign lines are shown in black.

The appellant's system alone would not require more than 12½% of the capacity of the Dresser plant. It is only by combining the load of the affiliated companies that a sufficient demand is created to justify the construction of the Dresser plant. The interconnection of the systems of the affiliated companies and the delivery of current to the affiliated utilities is necessary in order that appellant may be able to secure a supply of cheap energy from that plant. No one of the affiliated companies has a sufficient demand to justify the construction of the plant without cooperating with the other affiliated companies in the enterprise. It is admitted by the defendant's witness Abbett that appellant could not have the advantage of cheap current generated in a large plant unless it joined with the affiliated companies (R. 256), and that Martinsville would have to obtain its current from such a system in order to get the advantage of low cost of generating energy (R. 261). If Martinsville were to get its current direct from the Dresser plant by building an independent line direct to that plant the cost would be prohibitive (R. 260).

The economic advantage of a large generating station like the Dresser plant over a small local plant is conceded by appellees (R. 79). It is admitted that electrical energy can be generated in a large plant like the Dresser plant and delivered by an interconnected transmission system, such as appellant operates, more cheaply than it can be generated locally for a city such as Martinsville (R. 268).

The Dresser plant was placed in operation in 1924 (R. 181). By that time the affiliated companies had acquired and interconnected their respective properties. Each company built transmission lines in its respective territory and these transmission lines were interconnected so that a supply of electrical energy could be drawn from the plant by all the affiliated companies.

The appellant produced five electrical engineers, Mr. Andrus (R. 180), president of appellant; Mr. Spooner (R. 195), Mr. Cook (R. 208), Mr. Burnell (R. 218) and Mr. Sittinger (R. 223), and the defendants produced Mr. Abbett (R. 242), Mr. Wenger (R. 261) and Mr. Husselman (R. 266), as witnesses, and it was agreed by all of them that the plan of appellant and the affiliated companies for generating and transmitting electricity was the accepted and approved method of conducting an electrical business at the present time; (R. 78 to 81), that Martinsville is better off as a part of such system than it would be if its electrical supply was generated in an isolated plant located in the city of Martinsville; that Martinsville could not have the benefits of economical generation of electricity in a large, well located generating plant unless it were a part of a system large enough to support such a generating plant.

It is apparent, then, that only as a part of a larger whole could Martinsville be thus served. It is served as a part of the appellant's system, and that system is able to have the economies of the generation of electricity in large units only because it is a part of the system maintained by the affiliated companies which draw their supply from the Dresser plant (R. 256 and 261). In other words, the cities, towns and communities in appellant's system are mutually dependent upon each other and must be interconnected with the affiliated companies to build up a large enough load to make possible the Dresser plant and the economies

resulting from it. None, without the others, could have the existing service (R. 186 and 207). Likewise, the cities, towns and communities in the territories of the affiliated companies are dependent upon each other and must be interconnected with appellant to build up the required load. Each company was necessarily required to do its share of building transmission lines in its territory to make the system possible.

In order that a company may successfully sell it electrical service it must be able to supply a reliable, dependable and uninterrupted supply of energy. To do this appellant must be able to procure energy from more than one generating station and transmit it to its customers in each city, town or community from more than one direction (R. 79). The most economical way to obtain energy from more than one source is to have a main generating station, such as the Dresser plant, as a source of supply and then to be interconnected with other stations for reserve and emergency supply. The Dresser plant must from time to time be shut down for periodical repairs. It will, by accident, break down at times and there would be interruption in the service if the system were not interconnected with other sources of supply. To guard against this and to meet the peak demand the appellant maintains three small generating plants located at Martinsville, Sullivan and Clinton. These three small plants are not used locally but are connected with the system and used to supply system demands. Northern Indiana Power Company, also, has a large generating plant at Kokomo (R. 181). It is likewise used for system supply. Generating plants of foreign companies are connected with the system and power may be transmitted from these sources in cases of emergency. Through the 66 K. V. line of appellant through Clinton, Attica and Lafayette

the appellant may, in case of need, draw power from the Kokomo plant of the Northern Indiana Power Company, from hydro-electric plants at Norway and Oakdale, Indiana, owned by Indiana Hydro Electric Power Company, an Indiana utility corporation, and from a large plant at South Bend, Indiana, owned by the Indiana and Michigan Electric Company, another Indiana utility.

In addition to interconnecting the various generating plants, thereby assuring reliable, dependable and uninterrupted service through multiple sources of supply, the transmission system also affords the communities the further insurance of a supply from two directions (R. 79). Thus, the high tension transmission line of the affiliated companies forms a main service loop which may be described as follows: From the Dresser plant northeasterly to the Lenore substation south of Indianapolis; from the Lenore substation north to Kokomo; from Kokomo west to Lafayette; from Lafayette southwest to Attica; from Attica south to Clinton and Terre Haute. This appears clearly on the diagram map (R. 274). By this means, if there is a break in the transmission loop at any point a town is not deprived of energy but the supply will come in from the other side of the loop. If a single line ran from the Dresser plant to Covington, a break at any point between Dresser and Covington would deprive appellant's customers in Covington of service, but with Covington connected to the loop a breakdown between Dresser and Covington would not deprive Covington of service because the energy would come round by the Lenore substation, Kokomo, Lafayette and Attica to Covington. The map (R. 274) also shows smaller loops in addition to the large one described.

This plan of interconnection of systems to afford a supply from several generating stations and by means of at

least two transmission lines (the loop service being the equivalent of two transmission lines) is recognized as the most reliable, dependable and economical way of supplying an uninterrupted service to a community.

The major advantages to the public resulting from the operation by appellant of an interconnected utility system constituting a single electrical operating unit serving numerous cities and towns, including rural communities, may be summarized as follows:

(1) It provides a large enough demand to make possible securing a cheap supply of electrical energy from large generating units which are the most economical means of generating electricity.

(2) It results in an improved load factor which makes for economy through a greater use of the facilities (R. 184 and 185).

(3) Less reserve equipment is necessary, thereby making for economy (R. 181).

(4) It supplies the means of continuous, reliable and uninterrupted service at a smaller cost than it could be supplied for each town individually (R. 181).

(5) It results in standard schedules of uniform rates for the same classes of service, eliminating discrimination among the several communities interconnected (R. 185 and 192).

(6) It aids industrial development of the territory as it is essential that industries have cheap, reliable, dependable and uninterrupted service (R. 184 and 185).

(7) The development of rural territory is made possible and thereby an improved load factor obtained (R. 181, 184, 185).

The appellant has established and maintained uniform rates for the same classes of service in the cities, towns and communities of the same class. All rates have been approved by the Public Service Commission of Indiana (R. 192). Since the organization and construction of appellant's interconnected system in 1923 over one hundred rate reductions have been made (R. 192). The appellant submits that these undisputed facts show that it has built an economical and beneficial system for supplying electrical energy in the entire territory it serves as a single unit (R. 186); and that by so doing it supplies Martinsville with energy more cheaply than it could be supplied as a separate municipality. This system is beneficial to Martinsville and the city has no equity in demanding the benefits of the service at less than the actual cost of the service.

Although appellant's contention that the challenged rates must be tested as to their constitutional validity by their effect upon appellant's system-wide operations was raised and argued by appellant in the lower court, one will search the opinion of the lower court in vain for any ruling upon that question. The lower court not only studiously avoids any consideration or discussion of the constitutional rights upon which appellant predicates its present contention, but assumes the very question at issue against appellant, not on constitutional grounds, but—strangely for a court facing a constitutional question—on the avowed grounds of public policy (R. 146-148).

The lower court held that the state could constitutionally treat Martinsville as a segregated unit, not by a construction or consideration of the federal constitution, but by construing and considering the state law of Indiana under which the Public Service Commission thereof is operating. It is self-evident that appellant's constitu-

tional rights under the federal constitution do not originate in, and are not in any wise dependent upon or determined by the Indiana statutes howsoever such statutes may be construed.

In respect to the proper construction of the Indiana statute, we believe it is entirely clear that there is nothing either in the history or on the face of such statutes requiring that municipalities be treated as segregated rate units, but that on the contrary both the history and wording of the statutes disclose an unmistakable intention on the part of the legislature not that municipalities should be the rate unit, but that the entire system-wide properties of a utility such as appellant's should be the rate unit. (See Vol. 3, Burns' Annotated Indiana Statutes 1926, Secs. 12672, 12680, 12682, 12683, 12689, 12712, 12718).

The lower court in construing the statutes as it did relied upon two principal grounds (1) that if the construction contended for by appellant were sound it would make it necessary to have all the property of the entire system appraised each time a municipality petitioned for a revision of its rates and that such expense, if allowed to the utility as an operating expense, would be so great in many, if not in all cases, as to prevent any reduction of rates and (2) that the Indiana statutes had been patterned after the Wisconsin act and that the courts of that state had held in *City of Eau Claire* v. *Railroad Commission*, 178 Wis. 207, 189 N. W. 476, that the commission of that state was required under the Wisconsin act to treat the municipality as the rate unit.

Appellant's answer to the first of such grounds is twofold, namely, (1) that as long as appellant is in good faith asserting its constitutional rights it should not be penalized by being deprived of the right to charge such expenses as an operating expense, regardless of what may

be the final determination of its constitutional rights; and (2) that the argument founded on expense is self-annihilating in that even if Martinsville is to be treated as a segregated rate unit an allowance must be made for depreciation and return on appellant's power system property located outside of Martinsville and in the eleven counties served. Obviously, before the amount so to be included can be determined, the value of the power system property would have to be determined. Appellant's power system property is approximately two-thirds of its entire property. In any event, therefore, a valuation of the power system property would be necessary even under the District Court's method of calculation, and hence the expense argument as a legal and practical matter loses much, if not all, of its force. In fact this very item of expense is one of the reasons advanced by the commissions of many of the states, including the Indiana commission (see P. U. R. 1924A 1, 8-9), in the decisions hereinafter cited for refusing to treat the municipality as a segregated rate unit. The constitutional guaranty is against confiscation of appellant's property. Municipalities are not guaranteed cheap rate cases.

As to the second ground relied upon by the District Court, namely the *Eau Claire case,* the answer is that that case presented no question of confiscation but merely one of discrimination among municipalities served from an interconnected electrical system. This is clear from the following quotation from the case (178 Wis. 207, 189 N. W. 476 at 480):

> "But in this case there is no contention that the rates fixed yield an unreasonable return to the utility. The complaint is that the return to, or income of, the utility resulting from the rates fixed by the order under review is unlawfully and unreasonably distrib-

> uted among the municipalities constituting the so-called loop system. This brings us down to the single question of whether the commission was acting within the legislative command in treating the loop system as a unit for the purpose of fixing the rates to be charged by the Wisconsin-Minnesota Light and Power Company. This question does not find its answer in any express provision of the statutes."

It is apparent from the above quotation that the issue in the Wisconsin case had nothing to do with that which is here presented. The utility in that case was earning a fair return and the only question was the distribution of that earning power as among the several municipalities affected. Appellant's complaint in the present case is of the action of the commission in reducing rates in one community at a time when appellant's aggregate revenue from its property as a whole was already at a confiscatory level, by the master's own admission. How the District Court could have regarded the Wisconsin case as having any bearing upon that question we have been wholly unable to understand.

It is obvious, we submit, that the District Court erroneously construed the Indiana statute. But even if something could be spelled out of that statute to indicate that each municipality should be considered as a unit for rate making, it would mean only that rates should be uniform within the limits of each municipality—something no utility would question in any event, if on grounds of policy alone—and would have no bearing upon the question whether or not a modern, interconnected electrical system lawfully designed to serve a group of municipalities could be constitutionally deprived of the right to earn a fair return by the process of imposing preferential rates for certain municipalities.

We submit that the rate base for the determination of the charges to be made by appellant to customers who happen to live in Martinsville or customers who happen to live in any other of the communities situated on appellant's interconnected system is the property constituting that system as a whole; that that property cannot be arbitrarily split up into theoretical fractions applicable to the numerous communities in question; that no power resides in the State of Indiana, acting through any public body or official or under any form of procedure, to impose rates upon appellant for any particular group of customers forming a part of the total group which appellant has elected to serve unless such rates when considered in connection with all of the other rates to be charged by appellant to the remainder of its entire group of customers shall be sufficient to enable it to earn a fair return upon its property as a whole; and that for the failure to enforce this constitutional principle the decree of the District Court should be reversed.

It is established by undisputed evidence:

(1) That appellant's system, as a whole, is earning only 4.15% on its value (R. 131).

(2) That appellant's rates in the various cities, towns and communities served by it are uniform for the same classes of service (R. 185 and 192); and

(3) That the rates fixed by the Commission for Martinsville amount to approximately a 15% reduction (R. 313 and 319).

As said by Mr. Justice Brewer in *Chicago, Milwaukee & St. Paul Railway* v. *Tompkins*, 176 U. S. 167 at 176:

> "Such a result indicates that there is something wrong in the process by which the conclusion is reached."

No conclusion, however plausible the reasoning advanced in support of it, is admissible if upon undisputed facts it can not properly be reached.

Minnesota Rate Cases, 230 U. S. 352, at 460.

What is wrong with the reasoning leading to the District court's conclusion?

The district court in its opinion never considered the constitutional question in determining what property constituted the rate base. It considered the constitutional question only after fixing the rate base, *i. e.*, as applied to the rate base fixed by it (R. 146 to 151). The charge by appellant's bill is confiscation. The District court overlooked the fact that rate making is no function of a court. Its duty was to inquire concerning results and to uphold the guarantees which inhibit the taking of private property for public use without just compensation under any guise. This duty it failed to perform.

Pacific Gas & Electric Company v. *City and County of San Francisco,* 265 U. S. 403, at 415.

It is well settled that the basis of calculation of utility rates is the fair value of the property used for the convenience of the public.

Minnesota Rate Cases, 230 U. S. 352, at 434-5.

In the case of *Smyth* v. *Ames,* 169 U. S. 466, at 547, Mr. Justice Harlan defined the utility's constitutional right as:

> "A fair return upon the value of that which it employes for the public convenience."

This definition has been adhered to in all subsequent cases.

In *McCardle* v. *Indianapolis Water Company,* 272 U. S. 400, at 408, Mr. Justice Butler uses the expression:

> "Just compensation for the use of the property employed to furnish the service."

In *Southwestern Bell Telephone Company* v. *Public Service Commission,* 262 U. S. 276, at 287, Mr. Justice Reynolds used the words:

> "A fair return upon properties devoted to public service."

Confiscation cannot be predicated on a single rate or group of rates, but must be judged from the effect on the entire business done by the utility within the area served. In *Willcox* v. *Consolidated Gas Company,* 212 U. S. 19, at 54, the court said:

> "We cannot see from the whole evidence, that the price fixed for gas supplied to the city by the wholesale, so to speak, would so reduce the profits from the total of the gas supplied as to thereby render such total profits insufficient as a return upon the property used by the complainant. So long as the total is enough to furnish such return, it is not important that, with relation to some customers the price is not enough."

In *State Public Utilities Commission* v. *Springfield Gas & Electric Company,* 291 Ill. 209, at 228 and 229, it was contended:

> "That the cost of supplying gas to the small consumer is greatly in excess of the amount allowed in the schedule established by the Commission, and that the burden of paying the return on the capital invested is placed on one-third of the output of gas,—that is the third taken by the large consumers. The point here in question was passed upon by the Supreme Court of the United States in *Willcox* v. *Consolidated Gas Company, supra,* where objection was made on behalf of the company to the reduced rate fixed for gas supplied to the city. It was there said:

'Lastly, it is objected that there is an illegal discrimination as between the city and the consumers individually. We see no discrimination which is illegal or for which good reasons could not be given. But neither the city nor the consumers are finding any fault with it, and the only interest of the complainant in the question is to find out whether by the reduced price to the city the complainant is, upon the whole, unable to realize a return sufficient to comply with what it has the right to demand. What we have already said applies to the facts now in question. We cannot see, from the whole evidence, that the price fixed for gas supplied to the city by wholesale, so to speak, would so reduce the profits from the total of the gas supplied as to thereby render such total profits insufficient as a return upon the property used by the complainant. So long as the total is enough to furnish such return, it is not important that, with the relation to some customers the price is not enough'."

In *Michigan Bell Telephone Co.* v. *Odell,* 45 Fed. (2d) 180 (Dist. Ct. E. D. Mich. S. D. 1930), the court said at pp. 181-182:

"The separable contention of the city of Detroit that, in determining the reasonableness of the telephone rates in effect in the Detroit exchange, the property, revenues, and expenses of the plaintiff involved in the furnishing of telephone service in that city should be segregated from those involved in connection with the other exchanges in the state, and that, if that be done, the present rates prescribed by the commission for the Detroit exchange are sufficient to afford a fair return upon the fair value of the plaintiff's property devoted to the furnishing of service in

such city, was held by the master to be contrary to established law on this subject, for the reason that *in determining whether rates prescribed by a state for a public utility are confiscatory, the property, revenues, and expenses of such utility ought to be considered on a state-wide basis.* With this conclusion we agree, and the master is in this respect confirmed upon the authority of *St. Louis & San Francisco Railway Company* v. *Gill,* 156 U. S. 659, 667, 15 S. Ct. 484, 491, 39 L. Ed. 567, 673; *Puget Sound Traction Light & Power Company* v. *Reynolds,* 244 U. S. 574, 37 S. Ct. 705, 61 L. Ed. 1325; *New York Telephone Company* v. *Prendergast* (D. C.) 36 F. (2d) 54; *United Gas Company* v. *Kentucky Railroad Commission,* 278 U. S. 300, 49 S. Ct. 150, 73 L. Ed. 390."

In *New York Telephone Co.* v. *Prendergast,* 36 Fed. (2d) 54 (Dist. Ct. S. D. N. Y. 1929) the court said at p. 69:

"The defendants have moved to refer the proceeding back to the master to make separate findings as to the confiscatory effect of the rates for New York City and rates outside of the city. The court is not engaged in the task of rate fixing. The question is one of confiscation, that is, whether the plaintiff is able to earn a fair return on a fair value of its property devoted to its entire intrastate business. The master has properly considered the rates as a whole and found the values as to the property devoted to intrastate service within the state. He separately found the values for the city of New York and outside the city for the rest of the state. No good or lawful reason is advanced why there should be separate findings as to the effect of the city rates and outside the city rates respectively; our concern is whether all the rates imposed by the commission are remunerative or

confiscatory, and we leave to the commission the readjustment of the rates upon our finding that it is confiscatory. *Prendergast* v. *N. Y. Tel. Co.*, 262 U. S. 43, 43 S. Ct. 466, 67 L. Ed. 853; *Northern Pac. Ry.* v. *No. Dakota*, 236 U. S. 585, 35 S. Ct. 429, 59 L. Ed. 735, L. R. A. 1917F, 1148, Ann. Cas. 1916A, 1; *Love* v. *Atch. T. & S. F. Ry. Co.* (C. C. A.) 185 F. 321."

In *United Railways* v. *West*, 280 U. S. 234 (1930) the court said at pp. 252-253:

"Complaint also is made of the action of the commission in abolishing the second fare zone established by the company on what is called the Halethorpe line and substituting a single fare for the two fares theretofore exacted. Halethorpe is an unincorporated community lying outside the limits of Baltimore city. *With a single fare, the extension of the line to Halethorpe is not profitable, but, nevertheless, it is an integral part of the railway system, and it will be enough if the commission shall so readjust the fares as to yield a fair return upon the property, including the Halethorpe line, as a whole.* If, in doing so, the commission shall choose, not to restore the second fare, but to retain in force the single fare, we perceive no constitutional objection."

In *St. L. & San Francisco Railway* v. *Gill*, 156 U. S. 649 (1895), the court said at pages 665 and 666:

"It therefore appears that the allegations made and the evidence offered did not cover the company's railroad as an entirety *even in the State of Arkansas*, but were made in reference to that portion of the road originally belonging to the St. Louis, Arkansas and Texas Railway, and extending from the northern boundary of Arkansas to Fayetteville in said State. In this

state of facts we agree with the views of the Supreme Court of Arkansas, as disclosed in the opinion contained in the record, and which were to the effect that *the correct test was as to the effect of the act on the defendant's entire line,* and not upon that part which was formerly a part of one of the consolidating roads; that the company cannot claim the right to earn a net profit from every mile, section, or other part into which the road might be divided, nor attack as unjust a regulation which fixed a rate at which some such part would be unremunerative; that it would be practically impossible to ascertain in what proportion the several parts should share with others in the expenses and receipts in which they participated; and, finally, that to the extent that the question of injustice is to be determined by the effects of the act upon the earnings of the company, the earnings of the entire line must be estimated as against all its legitimate expenses under the operation of the act within the limits of the State of Arkansas."

A note on "The Municipality as a Unit for Utility Valuation" appears in Vol. 14 Yale Law Journal, page 912 (April, 1932) in which the case at bar is cited.

In *Puget Sound Traction Co.* v. *Reynolds,* 244 U. S. 574 (1917), the court said at pp. 580-581:

"But we cannot accede to the suggestion that the question whether the commission's order is confiscatory or otherwise arbitrary within the inhibition of the Fourteenth Amendment is to be determined with reference alone to the Alki, the Fauntleroy, or the Ballard Beach lines. These are and long have been operated by plaintiff as parts of a system comprising two hundred miles of tracks. The commission found that the net earnings of the system for the year end-

ing February 28, 1915, not including depreciation and taxes, were upwards of $1,600,000; that the company had refused to produce the valuations of its property made by experts, and had failed to show that there was not sufficient return from its property to pay operating expenses, taxes, and depreciation, and leave a balance. And from the evidence introduced the commission found the fact to be that, allowing for the services required by its order, the company would have net returns over and above operating expenses, taxes, and depreciation. It was not and is not contended that the system earnings are unremunerative."

In *New York & Queens Gas Co.* v. *McCall*, 245 U. S. 345 (1917), the court said at pp. 350-351:

"There is no showing in the record as to the fair value of the entire property of the Gas Company used in the public service, nor of the rate of return which it was earning thereon, and therefore even if the return on the cost of complying with the order be conceded to be inadequate, this would not suffice to render the order legally unreasonable. * * *

"These references to the evidence will suffice. They show this Public Service Commission ordering a public service corporation to render an important public service, under conditions such that in the aspect least favorable to the Gas Company the initial return upon the investment involved would be low but with every prospect of its soon becoming ample, and also that no claim was made by the company that the comparatively small loss which the company claims would result would render its business as a whole unprofitable."

In *New York, ex rel.* v. *Pub. Ser. Com.*, 269 U. S. 244 (1925), the court said at pp. 248-249:

"The court will not substitute its own judgment as to what extensions are reasonable for the determination of the commission. *New York & Queens Gas Co.* v. *McCall*, 245 U. S. 345, 348. But it will consider the advantages to result to the public from the extensions ordered; it will also consider the investment required to make the necessary additions to property, the cost of furnishing gas in the added territory, the effect of the new service upon the company's income as a whole; and, if it appears that the power to regulate was so used as to pass beyond the exercise of reasonable judgment and to amount to an infringement of the right of ownership, the order will be held invalid as repugnant to the due process clause."

In *Norf. & West. Ry.* v. *West Virginia*, 236 U. S. 605 (1915), the court said at pp. 608-609:

"The fundamental question presented is whether the validity of the passenger rate can be determined by its effect upon the passenger business of the company, separately considered. What has been said in the opinion in *Northern Pacific Railway* v. *North Dakota*, decided this day (*ante*, p. 585), makes an extended discussion of this question unnecessary. It was recognized that the State has a broad field for the exercise of its discretion in prescribing reasonable rates for common carriers within its jurisdiction; that it is not necessary that there should be uniform rates or the same percentage of profit on every sort of business; and that there is abundant room for reasonable classification and the adaptation of rates to various groups of services. It was further held that despite this range of permissible action,

> **the State has no arbitrary power over rates; that the devotion of the property of the carrier to public use is qualified by the condition of the carrier's undertaking that its services are to be performed for reasonable reward; and that the State may not select a commodity, or class of traffic, and instead of fixing what may be deemed to be reasonable compensation for its carriage, compel the carrier to transport it either at less than cost or for a compensation that is merely nominal."**

The Minnesota Rate Cases, 230 U. S. 352 (1913), involved, among other things, the question as to whether or not certain maximum rates for freight and passengers as fixed by the state of Minnesota were confiscatory. Enunciating the general principles applicable to testing the constitutional validity of challenged rates, the court said at p. 434:

> "The basis of calculation is the 'fair value of the property' used for the convenience of the public. *Smyth* v. *Ames, supra* (p. 546). Or, as it was put in *San Diego Land & Town Co.* v. *National City, supra* (p. 757), 'What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public.' See also *San Diego Land & Town Co.* v. *Jasper, supra; Willcox* v. *Consolidated Gas Co., supra.*"

In *Ames* v. *Union Pacific Railway Company,* 64 Fed. 165 at 179 (Aff. in 169 U. S. 466), Mr. Justice Brewer in a case concerning intrastate rates in Nebraska held that the effect of the reduction on the entire system must be considered.

The selecting of the units of service is a problem of management and in the absence of any suggestion of illegality or mismanagement in acquiring or operating the property, obviously those parts of the system which are unprofitable must be taken with those that are profitable.

Groesbeck v. *Duluth, etc., Railway,* 250 U. S. 607, at 612.

The value in question is that of the property actually used and not of what may be considered by some one to be an efficient substitute.

McCardle v. *Indianapolis Water Company,* 272 U. S. 400 at 417-418.

The right to regulate utilities in the interest of the public is very great. But great as the power may be it does not warrant an unreasonable interference with the right of management or the taking of the carrier's property without compensation.

Chicago, Milwaukee & St. Paul R. R. v. *Wisconsin,* 238 U. S. 491 at 501.

There is nothing in the instant case to indicate bad faith. On the contrary the evidence shows prudent management by the Board of Directors of appellant about a matter requiring business judgment. While the state may regulate with the view to enforce reasonable returns and charges it is not the owner of the property of the utility and is not clothed with the general power of management incident to ownership. The Commission is not the financial manager of the corporation and is not empowered to substitute its judgment for that of the directors.

Southwestern Bell Telephone Company v. *Public Service Commission,* 262 U. S. 276 at 288-289.

United Gas Company v. *Railroad Commission,* 278 U. S. 300, at 320-321.

It is an elementary principle that the owner of the property must elect to serve the public before becoming a public utility.

Producers Transportation Company **v.** ***Railroad Commission,*** **251 U. S. 228, at 230-31.**

The owner, by devoting his business to a public use, in effect grants the public an interest in that use and subjects himself to public regulation to the extent of that interest although the property continues to belong to its private owner and to be entitled to protection accordingly.

Munn **v.** ***Illinois,*** **94 U. S. 114 at 126.**

Wolff Company **v.** ***Industrial Court,*** **262 U. S. 522, at 535.**

But broad as is the power of regulation the state does not enjoy the freedom of an owner. The fact that the property is devoted to a public use on certain terms does not justify the requirement that it should be devoted to other public purposes, or to the same use on other terms, or the imposing of restrictions that are not reasonably concerned with the proper conduct of the business according to the undertaking which the utility has expressly or impliedly assumed. If a railroad has held itself out as a carrier of passengers only, it cannot be compelled to carry freight. Public interest cannot be invoked as a justification for demands which pass the limits of reasonable protection and seek to impose upon a utility and its property burdens that are not incident to its engagement.

Northern Pacific Railway Company **v.** ***State of North Dakota,*** **236 U. S. 585, at 595-6.**

The owner of a utility property is protected in that he must first elect to serve the public, and it is only to the extent that he devotes his property to public use that he in effect grants the public an interest in that use and

subjects himself to public regulation. But having done so he is still protected in that he cannot be required to devote it to other public purposes or to the same use on other terms. Burdens cannot be imposed upon his property that are not incident to its engagement in the use to which he dedicated it, according to the terms of the undertaking which he has assumed.

These principles we understand to be fundamental. Applied to this case they clearly mean that appellant is protected in the dedication of its property as a unit to the public service and that the state under the guise of regulation may not dismember that property and subject portions of it to uses to which appellant has never submitted them. It is plainly apparent that the owner might be perfectly willing to serve fifty interconnected towns as a unit, and not be willing to serve any of them separately. The constitution protects the owner in his right to own and operate his electrical property in such reasonable and lawful operating units as he may select. Having by reasonable and lawful methods acquired a given operating unit of utility property, he has the constitutional right to insist that that unit shall as a whole be permitted at all times to yield to him a fair return upon its value, and that the state may not, whatever its local forms, deprive that unit of property of such earnings. There is no suggestion in this record of unreasonableness or unlawfulness in the establishment of the operating unit serving the fifty towns, cities and rural communities located on appellant's interconnected system. On the contrary all of the evidence establishes the reasonableness and economy of the system. The public served consists of the entire body of the customers reached by the property operated as a unit and not some geographical subdivision of that public. There is no more justification for dividing this property into

geographical units than for dividing a city into sections. It might as sensibly be argued that the only property to be considered is that physically necessary to serve the seventeen persons who complained about the rates. Martinsville cannot live alone or be served alone, in the economical manner it is served, any more than could a single citizen of Martinsville. Martinsville willingly accepts all the benefits of the interconnected system, but would like to throw the burden of its fair share of high voltage transmission lines on the other customers of appellant and the affiliated untilities. If the commission was determined, as appears from its order, to confer upon customers living in Martinsville a preferred position over appellant's other customers, it was the commission's inescapable duty to compensate appellant by ordering appropriate increases in the rates charged to all other customers, to such an extent that the earnings realized by appellant upon its property as a whole should equal a fair return upon that property. To order a rate reduction in Martinsville in the face of the fact that the property as a whole was already earning less than a fair return was confiscation of the property as a whole. This confiscation it was the solemn duty of the District court to undo. It was no answer for the court to assert that the property as a whole was not useful in serving the customers located in Martinsville. Appellant has never undertaken to serve those customers alone. They were merely a part of a very much larger number of customers all of whom it had undertaken to serve by means of a property very much larger than that required to serve the Martinsville customers alone. It was this much larger property designed for the service of this much larger number of customers that appellant had lawfully acquired and lawfully dedicated to the specific public service of serving that larger group

of customers. As appellant had never designed nor built its system for the service of customers living in Martinsville considered apart from customers living in the numerous other communities for whose service also the system as a whole was designed and built, no power existed in the public, acting through a public service commission or otherwise, to make rates for those customers who happened to live in Martinsville in disregard of the effect of those rates upon the earnings derived by appellant from its customers as a whole. And in the face of the explicit pronouncements of this court, above referred to, the District court was wholly without right, in determining the question of confiscation, to consider the property piecemeal and determine the case without reference to the effect of the commission's order upon the property's earnings as a whole.

It is clear that the time has come for a clear reannouncement, in unmistakable terms, of the principles heretofore enunciated by this court upon this subject, *i. e.* that the interest of the public in private property begins with and is measured by the election of the owner of that property to devote it to the public service; that except as so devoted it remains private property for all purposes and to every extent; that the devotion of the property to one public use does not justify the forcible subjection of it to another use; that devotion of a property to public use on certain terms does not justify the imposition by the public of other terms; that devotion of a property to public use as a whole does not justify public dismemberment of the property and regulation of such dismembered parts without regard to the effect upon the whole; that, in short, devotion of private property to public use includes, as a corollary, reservation by the owner of every private interest in the property other than those necessarily surrendered by such devotion,

and that such reserved private interest is as fully protected by the Constitution as all other private interests in property.

The public service commissions of the various states quite generally recognize that the proper unit for testing rates is the used and useful property which makes up the operating unit, and they have generally refused to make the municipality the rate unit. Among the commission decisions so holding are the following:

Re Public Service Company of Indiana, P. U. R. 1932B 186 (Ind.)

Re Indiana Bell Telephone Company, P. U. R. 1924A 1, 8-9 (Ind.)

Re Indiana Gas Light Company, P. U. R. 1921E 441, 443-444 (Ind.)

Glenview Improvement Club v. *Peoples Water Co.,* P. U. R. 1918F 187, 189 (Calif.)

Westminster v. *Consolidated Pub. Util. Co.,* P. U. R. 1919E 506, 514-515 (Md.)

City of New Castle v. *Bell Telephone Co.,* P. U. R. 1921B 378, 380-382 (Pa.)

Ben Avon Borough v. *Ohio Valley Water Co.,* P. U. R. 1917C 390, 419-420 (Pa.)

Re Chesapeake & Potomac Telephone Company, P. U. R. 1921B 97, 116-118 (W. Va.)

Re Utah Power & Light Co., P. U. R. 1921C 294, 311 (Utah)

Re Missouri Gas & Electric Service Company, P. U. R. 1921D 687, 688-690 (Mo.)

Re New York Telephone Company, P. U. R. 1922A 497, 499-500, 501-502 (N. Y.)

Walter R. Stone v. *New York Telephone Co.,* P. U. R. 1921D 736, 757-758 (N. Y.)

Re United Traction Company, P. U. R. 1927D 637, 647-648 (N. Y.)

Re United Utilities Co., P. U. R. 1922B 344, 345 (Ill.)

Re Illinois Commerce Commission v. *Rockford Electric Company*, P. U. R. 1929E 498, 501-502 (Ill.)

Re Commonwealth Water Company, P. U. R. 1922C 48, 56-57 (N. J.)

Re City of Eaton Rapids, P. U. R. 1922D 94, 109, 117 (Mich.)

Re City of Pontiac, P. U. R. 1923D 193, 216-218 (Mich.)

Re Edison Electric Illuminating Company, P. U. R. 1928D 859, 862-863 (Mass.)

Re Georgia Power Company, P. U. R. 1929B 156-157 (Ga.)

Re Green Mountain Power Corporation, P. U. R. 1930B 171, 176 (Vt.)

Re Wisconsin Telephone Company, P. U. R. 1931E 135, 136-137, 140-141 (Wis.)

II.

If power system property is to be allocated to Martinsville it must be on an actual use basis.

If Martinsville is to be treated as a segregated unit, (*a*) the allocation of power system property to Martinsville use, and (*b*) the fixing of a "gateway" cost for electric energy supplied Martinsville, must be on a use basis and not by averaging.

Second Assignment of Error (R. 174-176).

If, in fixing a rate base, segregating appellant's Martinsville property from the remainder of appellant's electrical system was not error, nevertheless the court erred because:

(*a*) It did not make a proper allocation of the property outside Martinsville used and useful in serving Martinsville and

(*b*) It did not properly determine the cost of electrical energy delivered at the Martinsville substation for distribution to Martinsville customers.

The master allocated 3.3% (R. 109) of the power system property to Martinsville. The master reached this percentage by an approximation based on (*a*) the ratio of kilowatt hours of electrical energy sold by the appellant to Martinsville customers for the year 1929 to the total kilowatt hours of electrical energy sold by the appellant during the year 1929, including deliveries to other utilities; (*b*) the ratio of Martinsville substation output for 1929 to the total output of all substations of appellant for the year 1929; and (*c*) the ratio of Martinsville peak demand in 1929 to appellant's system peak demand in the same year. (R. 108-109).

The ratio of kilowatt hours of electrical energy sold by appellant to Martinsville customers to the total system sales, would only vary from the ratio of Martinsville substation output to the total substation output, as the line losses in the Martinsville distribution system might be more or less than the line losses in the rest of the appellant's system. The ratio of Martinsville's peak demand to the total system peak demand, would only vary from the ratio

of (*a*) sales to customers, and (*b*) substation deliveries, as the peak demand in Martinsville might be higher or lower than the peak demand in the rest of the system. The tests made by the master show that (*a*) the line loss is heavier in Martinsville than on the rest of the system because Martinsville sales were only 3.027% of the total system sales, while Martinsville substation output was 3.34% of the total output of all of appellant's substations; and (*b*) that the peak demand in Martinsville is slightly lower than on the rest of the system, since the Martinsville peak demand in 1929 was 3.01% of appellant's system peak demand, although substation deliveries at Martinsville were 3.34% of the total output of all of appellant's substations.

Hence it is apparent, as applied to the facts of this case, that the three methods utilized by the master in determining 3.3 to be the percentage of the power system property to be allocated to Martinsville were in reality but different methods of measuring the same factors. Moreover, it must not be overlooked that all three methods did not exclude but instead included the wholesale deliveries by appellant to its affiliated utilities (Ex. 33, R-307; Ex. 106, R-309, R-109).

However the cardinal fact to be borne in mind relative to the instant issue is that both the master and court utilized the foregoing method of allocation solely because all of the witnesses, both for appellant and appellees, who testified in respect to the proper method of allocating a portion of the power system property to Martinsville, agreed that if Martinsville was to be treated as a segregated unit the foregoing method of allocation was the proper method of allocation, disagreeing only as to whether or not the inter-utility wholesale power deliveries should

be included or excluded in applying such method of allocation (R-227, 235, 248, 259).

The court approved the master's finding and apportioned 3.3% of power system property to Martinsville use (R-167-168).

The court in finding the cost of electrical energy delivered at the substation (*i. e.* "gateway") at the city of Martinsville, for local distribution in Martinsville, divided the total power system energy cost by the total of all substation meter readings and found an average energy cost of $.0133 per kilowatt hour (R-311), which price was accepted by the court as a proper gateway cost for electrical current delivered to Martinsville exclusive of an allowance for depreciation and return (R. 154 and 168). By so doing a low average cost was reached because the deliveries to the affiliated utilities of approximately one-half the current passing over appellant's system at $.01 per kilowatt hour were included in making such calculations.

Substantially one-half of the electrical energy delivered over appellant's system is delivered by it in wholesale quantities over the Clinton-Attica-Lafayette line to Attica Electric Company at Attica and Northern Indiana Power Company at Lafayette. This energy is purchased from Indiana Electric Corporation and resold to the affiliated utilities. This is a necessary part of the plan to make the central generating plant for the use of all economically possible. The affiliated utilities interchange energy with appellant and appellant may, in case of necessity, draw on the affiliated utilities to obtain a supply of energy for appellant's customers.

An analysis of the tables set forth at pp. 16-17, *supra*, discloses that, taking into consideration all the factors set forth in respect to the years 1927, 1928 and 1929, the year

1929 is more nearly representative than any other one year of all the operating factors present in appellant's business which, under the testimony hereinabove referred to, should be considered in making an allocation of appellant's power system property to Martinsville and in fixing a gateway cost for electrical energy furnished to Martinsville if such a cost must be fixed.

From this it follows that if the challenged rates can be shown to be non-compensatory on the basis of the figures for the year 1929 then it must follow that the rates are in fact confiscatory (*a*) because, all things considered, the year 1929 is the most favorable to appellees and the least favorable to appellant and (*b*) because, as above stated, the year 1929 is more nearly representative of all of the operating factors present in appellant's business which under the testimony hereinabove referred to and which under any conceivable rational method of procedure, should be considered in making an allocation of appellant's power system property to Martinsville and in fixing a gateway cost for electrical energy furnished to Martinsville.

The electrical energy delivered by appellant to the affiliated companies in 1929 was (R. 313 and 316):

To Northern Indiana Power Company	30,239,200	K.W.H.
To Attica Electric Company	6,014,822	"
To Indiana Electric Corporation	1,364,942	"
Total	37,618,964	K.W.H.

The electrical energy delivered by appellant in 1929 to affiliated utilities, Martinsville and other customers, and the percentages of each to the total, was (R. 310, 311, 315 and 316):

			% of Total
To affiliated utilities	37,618,964	K.W.H.	49.62
To Martinsville	2,532,798	"	3.34
To other customers	35,659,866	"	47.04
Total deliveries	75,811,628	K.W.H.	100.00

From this it appears that the Martinsville deliveries of energy are about 3.34% of the total and that the deliveries to affiliated utilities are 49.62% of the total.

It also is apparent that if the deliveries to affiliated utilities are eliminated, as appellant contends that they should be, then the percentage of the Martinsville deliveries to all other deliveries of appellant will be approximately doubled. The figures are:

			% of Total
To Martinsville	2,532,798	K.W.H.	6.63
To other customers	35,659,866	"	93.37
Total deliveries	38,192,664	K.W.H.	100.00

Therefore, in the light of the foregoing facts the crucial question on this branch of the case is as to whether or not in allocating a portion of appellant's power system property to Martinsville and in fixing a gateway cost for electrical energy delivered to Martinsville the wholesale deliveries should be included, thereby reducing the amount of property to be otherwise allocated to Martinsville by approximately fifty per cent. and thereby reducing the gateway cost for electrical energy delivered to Martinsville by approximately one-half of one cent per kilowatt hour.

The allocation must be based upon actual uses.

Smith v. *Illinois Bell Telephone Co.*, 282 U. S. 133 at 150-1.

Minnesota Rate Cases, 230 U. S. 352 at 458.

It is proper to classify services for rate making purposes.

Northern Pacific Ry. v. *North Dakota*, 236 U. S. 585 at 598-9.

Interstate Commerce Comm. v. *B. & O. R. R.*, 145 U. S. 263 at 281-2.

Interstate Commerce Comm. v. *Chicago & Western Ry.*, 209 U. S. 108 at 119.

Texas & Pacific Ry. v. *Interstate Commerce Comm.*, 162 U. S. 197 at 205-7.

Averaging methods such as were employed by the master and court are not proper.

Northern Pacific v. *Department of Works*, 268 U. S. 39 at 42-5.

Chicago, Milwaukee & St. Paul Ry. v. *Public Utilities Comm.*, 274 U. S. 344 at 351.

Wood v. *Vandalia R. R.*, 231 U. S. 1 at 3-4.

The differences between the delivery in 1929 of 2,532,798 kilowatt hours to a town like Martinsville for distribution to small retail customers in the town, and the wholesale bulk delivery in 1929 to other utility companies of 37,618,964 kilowatt hours, are apparent and sufficient to require a classification and treatment on a basis of use instead of the averaging method used by the master and district court. (R. 107) These differences may be summarized as follows:

(1) The quantity delivered to the other utilities is vastly greater, the deliveries to Martinsville being less than 7% of the deliveries to other utilities.

(2) The deliveries to the utilities are at high voltages of 66,000 volts, thereby avoiding all transformer losses, and the line loss to the affiliated utilities is only 2% as against the 14.48% average in Martinsville. (R. 108)

(3) The deliveries to the affiliated utilities are under interchange agreements whereby appellant has the right to draw from the affiliated utilities electrical energy to meet its reserve and emergency requirements. No such right exists as against Martinsville.

(4) The interconnection with the affiliated utilities for delivery of energy is for the express purpose of creating a sufficient load to make the Dresser plant commercially and economically possible, thereby making it possible for appellant to secure large quantities of energy at $.01 per kilowatt hour, which is much cheaper than it could be generated locally in Martinsville.

(5) The deliveries to the affiliated utilities are wholesale bulk deliveries and those to Martinsville are for local retail distribution by appellant.

(6) The element of competition affects the price of large wholesale deliveries more than retail deliveries. On account of the competitive element the affiliated utilities would not pay appellant more than $.01¼ per kilowatt hour prior to December 1, 1929, and would not pay more than $.01 per kilowatt hour after December 1, 1929. It is conceded (R. 256) that if appellant should attempt to charge the affiliated companies the average or gateway price fixed by the master and court that the affiliated companies would not take such current from appellant but would get it elsewhere and would leave appellant with only its own consumption which is but approximately 12½% of the amount required for operating the Dresser plant economically.

(7) The appellant, by joining the interconnected system, escapes a large investment in generating equipment and although to accomplish this it is required to make an investment in high tension transmission lines the investment in the transmission lines is enough less to enable appellant to furnish cheaper energy through the system as planned, constructed and operated than could be supplied from a local plant in Martinsville. (R. 181)

(8) The interconnection secures a better load factor, thereby resulting in a better use of the equipment (R. 184 and 185) and a lesser energy cost to Martinsville (R. 188).

(9) There are large industrial customers outside the corporate limits of cities to be served and the plan makes it possible to serve these large customers which is mutually beneficial to all concerned. (R. 181)

(10) The inter-utility deliveries take place solely over appellant's Clinton-Lafayette line.

(11) Although appellant absorbs a line loss on the inter-utility deliveries, still the expense of operating and maintaining the Clinton-Lafayette line is substantially fixed and therefore such expense would be the same even with the inter-utility deliveries eliminated (R. 186, 188).

(12) Substantially the same investment in the Clinton-Lafayette line would be required for serving appellant's own customers even if the inter-utility deliveries were eliminated, the only difference being that a copper conductor of a smaller size would probably be used (R. 186), the poles and other transmission equipment remaining the same.

The inter-utility deliveries by appellant are made over its 66 K. V. line between Clinton and Lafayette. For the year ending May 31, 1930, 89.44% (R. 302) of the energy

delivered over this line was delivered to Northern Indiana Power Company and Attica Electric Company and 10.56% was for the use of appellant's customers in the territory served by this line.

The master admitted

> "* * * that it is commercially expedient and economically sound for companies furnishing electrical current to make such interconnecting arrangements and obtain such current from large producing plants and distribute it to the ultimate consumers." (R. 112).

The master's reasons for not excluding the deliveries to affiliated utilities in determining the Martinsville rate base and in fixing the gateway cost of energy delivered to Martinsville appear at R. 112, 127-128.

The court approved the findings of the master (R. 169). The court's reasons for the non-exclusion of the deliveries to the affiliated utilities (R. 151, 154 and 166-7-8) do not add anything to the reasons advanced by the master.

The master in his finding No. IX (R. 78 to 81) found that the interconnection of the systems was necessary in order to build up a sufficient load to make the Dresser plant commercially expedient and to secure to appellant a source of supply of electrical energy at low cost. It is clear that it is necessary for the affiliated companies to cooperate, and join together, in order to build up a sufficient demand for electrical energy to justify the Dresser plant. While the master and the court concede this, they seem to think that the appellant, by so doing, furnishes its transmission line for the use of the other affiliated companies without receiving just compensation. This ignores the large benefit which both appellant and the city of Martinsville receive by reason of the arrangement. (R. 207). The district court would give to Martinsville the benefits to be de-

rived from generating electricity cheaply in a large station at Dresser without charging Martinsville with its proportionate share of the expenses necessary in order to build up a system sufficient to consume the output of the Dresser plant. The division of the power system property among the towns served by appellant on the basis of the ratio of consumption at Martinsville to the total deliveries over appellant's entire system gives Martinsville the entire benefit of the large deliveries to the affiliated utilities thereby depressing the percentage to approximately one-half of what it would be if such inter-utility deliveries were eliminated.

Martinsville is not being treated unfairly by eliminating such inter-utility deliveries because it receives energy at less than it would cost to generate it in a local Martinsville plant. The affiliated companies cannot be charged more than one cent per kilowatt hour because if the price is made larger they will buy elsewhere.

The absurdity of the action taken by the commission, the master and the court is disclosed when it is realized that by including the wholesale deliveries to the affiliated utilities approximately fifty per cent of appellant's entire power system was, in effect, allocated to the use of such deliveries whereas the evidence shows that only 89.44% of the Clinton-Lafayette line is in fact used in making such deliveries (R. 302), which is of the value of $905,979. (R. 304).

If an average cost is to be applied to determine the proper price for Martinsville it results not only in destroying all classification of service but in rendering impossible the very service which Martinsville now receives. In other words the allocation of the court and master leads to the paradox that the only fact which renders their own allocations possible—the continuance of the in-

ter-utility deliveries—will and shall be rendered impossible. The sale of energy to the affiiliated utilities, large power customers, and to all city gateways would have to be at the same average price. It would then become necessary to charge the affiliated utilities the average cost. This is impossible. Under the evidence the sales to them would cease (R. 256) and the rates at Martinsville would have to be increased. The evidence shows that competitive conditions prevent the charge of more than $.01 per kilowatt hour for the bulk sales to the affiliated utilities. In other words, the present classification as well as the possibility of continued service would be destroyed, and all now paying more than an average price would be reduced and all paying less than an average price would be increased. This method of calculation results in giving to Martinsville the benefits of the entire system and relieving it of its proportionate share of the necessary costs. Appellees would and do accept the benefits of a system in order to get a low average cost of power and disclaim the burdens of the system in order to escape the burden of a proportionate part of the property necessary to develop the system. The appellant charges the affiiliated utilities all that competitive market conditions will warrant, and the residue of the burden must necessarily fall upon appellant's retail customers. Since appellant has provided a system that gives Martinsville energy at a less cost than it could be provided in a local generating plant Martinsville has no equity in demanding a greater per cent of the economies of the system whatever method of allocation may be devised or employed.

Applying the test proposed by appellant in Exhibit 21 (R. 289) and dividing the total power system cost, after crediting such cost with the price of the sales to the affiliated companies, by the total kilowatt hours delivered to

appellant's retail customers the cost of energy at the Martinsville gateway is $.024996 per kilowatt hour, allowing 4% for depreciation and 8% for return on the power system property. The gateway cost found by the master upon allowing 4% depreciation and 7% return on the power system property is $.018 per kilowatt hour at the Martinsville gateway. (R. 128).

While appellant insists that under a proper allocation of appellant's power system property according to the use to which such property is put and in determining the proper gateway cost of energy to Martinsville, the wholesale deliveries to the affiliated utilities should be entirely eliminated as set forth in said Exhibit 21, (R. 288) still appellant, in order to demonstrate that the challenged rates are confiscatory on the basis of a use allocation least favorable to appellant and most favorable to appellees and hence are confiscatory on any conceivable allocation according to the use to which the property is put, is willing to eliminate from the power system property and from the power system expenses and hence from the Martinsville rate base and from the Martinsville gateway cost 89.44% of the value of the Clinton-Lafayette line and the total expense of the operation of that line, which percentage of said value and expenses is, on the basis of an allocation according to the uses to which the Clinton-Lafayette line is put, fairly attributable solely to the wholesale deliveries to the affiliated utilities (R. 239). This method of allocating out a portion of the value and expenses of the Clinton-Lafayette line to the wholesale deliveries to the affiliated utilities is shown by Exhibit 28 (R. 299-304) and results in a gateway cost of energy to Martinsville of $.022897 per kilowatt hour and this, appellant contends, is the very least gateway cost that can, under the facts and the evidence of this case, be consti-

tutionally fixed for Martinsville if it is to be treated as a segregated rate unit. Exhibit 28 shows that by eliminating the property devoted to inter-utility deliveries and dividing the actual power system cost among appellant's retail customers the average cost per kilowatt hour is approximately 28% higher than that fixed by the master and court.

The record shows that, excluding the wholesale deliveries to the affiliated utilities, one-half of the deliveries made by appellant to its retail customers are to large power customers such as gravel pits and coal mines located in the country outside the corporate limits of cities, towns and villages. (R. 181) The city of Martinsville is shown to have few industries that consume large amounts of electricity. (R. 157). The Martinsville load (R. 310) is approximately one-third residence lighting, one-third commercial lighting and one-third standard and large power. It is, therefore, obvious that Martinsville is treated fairly when it is averaged with the other towns and power customers of appellant after eliminating the inter-utility deliveries.

In fact when Martinsville is averaged with the other towns and power customers of appellant after eliminating the wholesale deliveries to the affiliated utilities as above set forth, Martinsville receives a more fair treatment than it is entitled to because under the evidence (R. 211) it is not possible for appellant to sell energy throughout its system at an average cost. The cost of energy per kilowatt hour to the power users outside the municipalities is less than the cost per kilowatt hour of energy delivered to the municipal gateways for the reason that the power users serve to build up a much greater load factor than do the municipalities and it is the large users of power who have made it possible to reduce rates and give Mar-

tinsville the benefit of low rates. (R. 185, 211) It is manifest, therefore, that the power consumer must be charged at a lower rate than the residence consumer (R. 226).

Consequently, when Martinsville is averaged with the other towns and power consumers of appellant after eliminating the wholesale deliveries of energy to the affiliated utilities Martinsville is treated on the basis most favorable to it and least favorable to appellant.

The method used by the commission, the master and the district court in allocating property and fixing a "gateway" cost for energy, was an averaging process, obviously wrong, which resulted in destroying not only all classification but all continuation of service and in charging to Martinsville energy at a very low average cost, less than was fair, and in charging Martinsville with the burden of only about one-half the property which is necessarily used and useful in supplying service to Martinsville and the other towns and cities in the system, of which Martinsville is an integral part.

To treat the inter-utility deliveries upon the same basis as deliveries to the consumer public also constitutes an invasion of the functions of the corporate management. Appellant's 66 k. v. line from Clinton to Lafayette and the inter-utility deliveries over it are an essential part of the plan of doing business adopted by the corporate management. If the commission or court does not recognize this use as a necessary incident of the plan of doing business, then the commission or court thereby takes upon itself the burden of corporate management and deprives the corporate officers of that privilege. In effect, it is substituting the judgment of the commission or court for the judgment of the corporate management as to the pro-

priety of the arrangements made to give effect to a business policy which is concededly sound by the electrical engineers who testified and is the economic cornerstone in the plan for serving the communities in the system as a single unit.

III.

Value of Property.

Third Assignment of Error (R. 176-178).

The court erred in finding the value of the appellant's used and useful property in the following particulars:

In finding (a) the fair value of appellant's entire electrical property was $4,594,887.00 when it was, in fact, of the fair value of not less than $5,556,091 (R. 176).

The only appraisals of the whole electrical property operated as a unit were those of Spooner & Merrill (R. 275) and Stone & Webster (R. 277). The master disregarded the Stone & Webster appraisal which was about 5% higher (R. 219) than the Spooner & Merrill appraisal. The master found a value of $4,594,887. (R. 130, 131) which was 82.7% of the Spooner & Merrill appraisal for no better reason than this: that he had found the value of the Martinsville local property to be $102,947 which was 82.7% of the Spooner & Merrill appraisal of $135,402. But even after the master had thus arbitrarily reduced the value of the property he found that appellant in 1929 realized a return of only 4.15% (R. 131) on its entire property.

A summary of the appraisals appears at page 19 of this brief.

The master used a method similar to that of the Public Service Commission of Missouri in *Southwestern Bell*

Telephone Co. v. *Public Service Commission*, 262 U. S. 276, at 283 and 284.

There is no evidence to support the finding of the master as to the value of the entire property. The original cost of the plant and property on April 30, 1930 as carried on the books of the appellant was $5,235,900.94, of which $4,904,686.94 was electric utility property. (R. 232 and 280). This does not include working cash, materials and supplies or going value. (R. 280). The total securities authorized by the Public Service Commission of Indiana during the years 1923 to 1927 (R. 281 to 287) to be issued by appellant for the acquisition of its property (R. 281) was $5,088,100. (R. 232). The evidence of original cost, capitalization and earnings (R. 280) support a valuation of not less than $5,556,091 fixed by Spooner & Merrill.

In *City of Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1, at page 8, the court said:

> "In view of the character of the judicial power invoked in such cases it is not tolerable that its exercise should rest securely upon the findings of the master, even though they be confirmed by the trial court. The power is best safeguarded against abuse by preserving to this court complete freedom in dealing with the facts of each case."

The court erred (b to e) in finding the value of the several parts of the appellant's property (R. 176-177); (f) in accepting the opinion of Abbett (R. 177) against all of appellant's evidence (R. 100), and (g) in finding that the unit prices used in making up the appraisal of Stone & Webster were too high (R. 177), the amounts added by them for general construction costs were unwarranted and that their allowance for organization, working capital, cost of financing and going value was exorbitant and un-

reasonable in each case, and that the findings of the witness Abbett in such respects were fair and reasonable. A summary of the appraisals and valuations appears at pages 19, 23, 25 of this brief.

The court accepted (R. 94 and 100) the opinion of the witness Abbett (R. 242) as to the principal items of property. On a few minor items where his value was obviously indefensible the opinion of Spooner & Merrill was adopted. The appellant offered the testimony of Charles W. Spooner (R. 195), Donald M. Cook (R. 208), William V. Burnell (R. 218) and Carl J. Sittinger (R. 223) appraisal engineers of wide experience. The master and the court in the main brushed appellant's evidence aside and accepted the opinion of the witness Abbett. It is strange that on a question of opinion as to value of property the opinion of one man should be accepted and the opinion of four men of much greater experience ignored. How Abbett could be 100% correct and the other four wrong throughout cannot be understood. This appears even more extraordinary when, as in this case, the book value, capitalization, earnings and orders of the Public Service Commission of Indiana authorizing appellant's securities support the opinion of appellant's witnesses.

Mr. Abbett is a young man of slight experience as compared with the four witnesses produced by appellant (R. 243 and 252). Abbett graduated from Purdue University as an engineer in 1916, watched switches a short time in a plant of the Indianapolis Light and Heat Company, went into the army, taught school and in 1919 became an assistant to the engineering staff of the Public Service Commission of Indiana, which position he still holds. During his connection with the commission he has been connected with about 100 appraisals of utility property. (R. 243). He has had no construction experience except in school

and his opinion on prices is based on catalogues and quotations, and his opinion on labor performance on mathematical calculations.

The appellant's witnesses are men known and generally recognized as engineers of standing and ability. Messrs. Spooner and Cook are graduates of the engineering school of the University of Michigan. Mr. Spooner (R. 195 to R. 197) has had practical experience as an electrical engineer since 1906 and Mr. Cook (R. 208) since 1915. They have both been intimately acquainted with appellant's property for the last ten years, during which most of it was built. Both have made appraisals of utility properties for rate cases, security issues, bank loans and purchases. The witnesses Burnell (R. 218) and Sittinger (R. 223) of Stone & Webster are two of the best qualified and best known appraisal engineers in the country. The master disregarded their testimony altogether, and the court approved his finding. Burnell graduated in 1904 and has been actively engaged since then in engineering work. Sittinger has had over 20 years' experience. The Stone & Webster organization is known by reputation throughout the world. The off-hand manner in which the master disposed of their evidence and disregarded their years of experience does no credit to his judgment and renders his findings indefeasible.

The witnesses Burnell (R. 218) and Sittinger (R. 223) who testified to the appraisal by Stone & Webster are men of unquestioned integrity and of very wide experience. Their appraisal was approximately 5% higher than the appraisal of Spooner & Merrill (R. 219). The reasons given for rejecting their testimony is not supported by the record in any respect but is simply the arbitrary and wilful determination of the master to disregard their testimony and opinion as to value and accept that of the wit-

ness Abbett. When all the corroborating facts as to book value, capitalization, earnings and orders of the Public Service Commission authorizing appellant's securities support the opinions of the appellant's witnesses there was no basis for the master and court to disregard their testimony and it was error to do so.

Cost of Financing.

The court erred (h) in finding that no costs of financing would be incurred in reproducing any of appellant's property, and in refusing to allow anything therefor; and in overruling appellant's exception number seven to that part of the report of the Special Master which finds that in fixing values on appellant's property for the purposes of this case, nothing should be included for the cost of financing. (R. 178).

Appellee's witness Abbett included nothing in his appraisal for cost of financing, but he admitted that a cost of financing would be incurred. (R. 258). The appellant's witness Cook (R. 210) testified that he arrived at the cost of financing by using the figures of Mr. Pennington and Mr. Kelley which, by arithmatical calculation is an average of 3.8% of the securities as a whole. Mr. Cook testified that he included nothing for cost of financing the common stock. The witness Burnell (R. 220) testified that he placed the cost of financing at the very conservative estimate of 5%. The witness Pennington (R. 193), engaged in marketing utility securities during the last eight years, testified that the selling cost of appellant's preferred stock would be from 5% to 10% of the par value, and the witness Kelley (R. 194) engaged in marketing utility securities during the last five years, testified that the selling cost of appellant's bonds would be from 4% to 5%. The cost of financing allowed in the appraisal of Stone & Webster (R. 277) is $270,000; and that allowed in the appraisal of

Spooner & Merrill is $182,185. (R. 275). As said by the Supreme Court of Pennsylvania, "Everybody knows that expenses are necessarily incurred" in the sale of securities. That court in *Bew Avon Borough* v. *Ohio Valley Water Co*,. 271 Pa. 346, 114 Atl. 369, at 373 said:

> "The last of the five questions is whether or not brokerage on the sale of the bonds of the water company should have been allowed? The Commission says that sufficient evidence of actual payment thereof was not produced, but everybody knows that expenses are necessarily incurred in such sales; even our Victory and Liberty Bonds could not be marketed except at a very heavy cost. There is no legal principle standing in the way of making a proper allowance therefor, and it is difficult to understand the basis of the mistake of those who hold it should not be allowed. The matter is in the same situation as if appellee had placed its bonds in the hands of an agent, with direction to sell them and apply the proceeds, as needed, for construction expenses. These bonds were all that the water company had to apply in payment of the plant, and the use thereof for this purpose, in the final analysis, constituted simply an exchange of one for the other. If it had been remembered that money itself has no value except that given to it by reason of the fact that other commodities can be obtained in exchange for it, the error of refusing to allow this as a principal expense would probably not have been made."

The decisions in *Galveston Electric Company* v. *Galveston*, 258 U. S. 388, at 397, and *Vincennes Water Supply Company* v. *Public Service Commission*, 34 Fed. (2d) 5, at page 9, seem to have eliminated the cost of financing from property valuations, giving as the reason that no actual

expense of financing was shown in the original building or acquisition of the properties. These cases overlook the fact that it is a hypothetical reproduction cost—not original actual cost—that is the subject of immediate inquiry. In determining the amounts to be included for other elements of reproduction cost, original cost is not controlling. It follows logically that the same rule should be applied with reference to financing costs as is applied to an estimate of the reproduction cost of the physical elements of the property.

IV.

Rate Case Expenses.

Fourth Assignment of Error (R. 178).

The court erred (M. F. 31, R. 113-116; C. F. 15, R. 168) in finding that only $4,000.00 should be charged to operating expenses for the expenses of this rate case and in overruling the appellant's exceptions, numbers 19 and 20 (R. 138 and 139) to that part of the report of the special master so finding, when the actual expenses were shown to be in excess of $60,000.00. (R. 237, 313, 314 and 317).

The commission by its order of January 26, 1929, directed that the rate case expense charged to Martinsville be amortized over a period of ten years and should not exceed $400.00 per year. (R. 52). By the same order the commission required appellant to pay to the State of Indiana $1,000.00 costs for the appraisal by the commission of appellant's local property at Martinsville (R. 52). The commission appraised appellant's local Martinsville property at $87,000.00 (R. 45). The expenses actually incurred in this rate case by appellant for the years 1927 and 1928 while the matter was before the commission as shown by the itemized statement (R. 317), were $25,972.64.

This case was instituted February 27, 1929, and after a hearing before the master the court allowed the master, for taking and reporting the evidence with his findings and conclusions, the sum of $4,500.00 (R. 142). Although these two single items of costs (*i. e.* $1,000.00 for the commission appraisal and $4,500.00 for the master's fees) aggregate $5,500.00 and alone exceed the allowance made by the commission, nevertheless the master (R. 116) and the court (R. 168) held that an allowance of $400.00 per year for ten years was a sufficient allowance on account of expenses reasonably incurred on account of this rate inquiry.

The appraisal of the power system property was admittedly necessary under the findings of the master and the court, the value found by the master and the court being $3,066,395 (R. 99 and 164). Allowing for this appraisal at the rate of charge of $1,000.00 for each $87,000.00 of value (being the rate allowed by the commission for the appraisal of the Martinsville local property) would add for the appraisal of the power system a charge of $35,000.00. The evidence of Mr. Schiesz is that the actual expenses of the rate case to May 31, 1930 were approximately $60,000.00 (R. 237). This is not questioned or disputed in any way. Appellee's Exhibit 111 (R. 317) shows itemized expenses in 1927 and 1928 aggregating $25,972.64 and Exhibit 107 (R. 313 and 314) shows $19,760.62 in 1929, making a total of $45,733.26. It is plainly apparent that either the allowance of fees by the commission for the appraisal and by the court for the master were exorbitant or the allowance of $400.00 for ten years was inadequate.

The appellant, in order to properly present the case, was obliged to secure appraisals by competent appraisal engineers, and the costs of its appraisals, witnesses and attorney fees are all proper items of expense. It did

not start the controversy. It had a right and a duty to defend itself.

The hearing before the commission took seven days. (R. 24 and 25). The evidence before the master commenced September 2, 1930 and was concluded September 19, 1930 (R. 73). The argument before the master was heard on December 18 and 19, 1930 (R. 73). The master was engaged eighteen days in preparing his findings and conclusions (R. 132). The master's findings were filed July 2, 1931 (R. 72 to 133) and the appellant filed exceptions July 22, 1931 (R. 133 to 141). The case was argued before the three judge court December 18, 1931 and an opinion and findings filed February 26, 1932 (R. 142 and 156). On May 10, 1932 this appeal was taken (R. 172). The transcript of testimony contained 2360 pages. In addition appellant introduced 34 exhibits and the defendant 41 exhibits. The inventories and appraisals contain approximately 1500 pages. The abstract has been condensed to 330 printed pages. This summary recital shows a large volume of work and a casual examination of the record is sufficient to support the expenses charged. There is no proof or even attempt to prove any abuse of discretion on the part of the corporate management in the matter of rate case expense.

Rate case expense has always been recognized as a proper operating expense and when it is large it should be amortized. It is more frequently amortized in 5 years rather than in 10 years, as was ordered in this case. The appellant is not complaining as to the ten year period but is complaining as to the amount. The allowance should not have been reduced beyond the actual expenditures proven which are not less than $60,000.00 and the annual amount to be amortized over the ten year period should be not less than $6,000.00 per annum.

In *Monroe Gas Light & Fuel Co.* v. *Michigan Public Utilities Commission,* 11 Fed. (2d) 319, 325, in discussing rate case expenses, the court said:

> "* * * we see no reason why the discretion of the utility managers should have been revised. It is to be remembered, as has often been said, that the commission is to regulate rates but not to manage the business. The extent to which the utility managers should * * * go *in defending what are claimed to be their stockholders' rights,* are matters peculiarly of business management. * * * As to all disbursements actually made within the limits of good faith, the managers' discretion must stand, unless it is abused. Particularly as to the cost of contest before the commission and the courts, it goes without saying that power by the commission to prevent the expenditure of reasonably necessary amounts cannot be assumed."

Rate case expense is recognized as a proper operating expense and when it is large it should be amortized, usually over a period of five years.

Greencastle Water Works Co. v. *Public Service Com.,* 31 Fed. (2d) 600 at 605.

New York & Queens Gas Co. v. *Prendergast,* 1 Fed. (2d) 351 at 375; P. U. R. 1924-E 59, 68.

Monroe Gas Light & Fuel Co. v. *Michigan Public Utilities Com.,* 11 Fed. (2d) 319 at 325; P. U. R. 1926-D 13, 25-6.

West Palm Beach Water Co. v. *West Palm Beach,* P. U. R. 1930-A 177 at 215. ($14,963.23 allowed for expenses)

Denver Union Stock Yards Co. v. *United States,* P. U. R. 1932-C 225 at 251. ($41,000.00 allowed for expenses.) 57 Fed. (2d) 735.

Brooklyn Borough Gas Case (Per Hughes) P. U. R. 1918-F 335, 358 ($8,648.00 per year for 5 years)

New York & Richmond Gas Co. **v.** ***Prendergast,*** **10 Fed. (2d) 167 at 181-2.**

Consolidated Gas Co. **v.** ***Newton,*** **267 Fed. 231, 255-6; Aff. 258 U. S. 165.**

Brooklyn Borough Gas Co. **v.** ***Prendergast,*** **16 Fed. (2d) 615 at 623.**

Mobile Gas Co. **v.** ***Patterson,*** **293 Fed. 208, 224. ($25,000.00)**

Illinois Commerce Commission **v.** ***Streator Aqueduct Co.,*** **295 Fed. 385, 391.**

The commission is not the financial manager of the corporation and it is not empowered to substitute its judgment for that of the directors of the corporation, nor can it ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the corporate officers.

Southwestern Bell Telephone Co. v. *Public Service Com.,* 262 U. S. 276 at 289.

Columbus Gas Light Co. v. *Public Service Com.,* 193 Ind. 399 at 404; 140 N. E. 538 at 540.

Public Utilities Com. v. *Springfield Gas & Electric Co.,* 291 Ill. 209, 234; 125 N. E. 891, 901.

Banton v. *Belt Line Ry.,* 268 U. S. 413 at 421.

Pittsburgh & Potomac Telephone Co. v. *Manning,* 186 U. S. 238 at 248.

People v. *Stevens,* 197 N. Y. 1; 90 N. E. 60 at 63.

Denver Union Stock Yards Co. v. *U. S.,* P. U. R. 1932-C 225 at 251. 57 Fed. (2d) 735.

Re Milwaukee Electric Ry. & Light Co., P. U. R. 1913-E 289 at 296.

V.

Rate of Return.

Fifth Assignment of Error (R. 178).

The court erred (M. F. 36, R. 118 and 119, C. F. 14, R. 168) in finding that a return of 7% upon the fair value of the property used and useful in the public service is a reasonable return and in overruling appellant's exception 21 (R. 139) to that part of the report of the special master so finding, when, in fact, a return of not less than 8% should have been allowed in order to avoid confiscation of appellant's property. (Testimony Spooner 195 and Burnell R. 218).

The appellees' witnesses, Abbett (R. 250), Wenger (R. 263), Husselman (R. 267) and Carter (R. 273) all testified that 7% per annum would be a fair rate of return on the property and 4% would be a fair amount for depreciation. The appellees' witnesses did not make any allowance for the accumulation of a surplus. The appellant's witness Spooner (R. 207) testified that it is necessary to have a rate of return of 7% per annum to take care of bond interest, debt discount, borrowed money and dividends, and that to accumulate a surplus the rate of return should be not less than 8% based on the fair value determined for rate making purposes. The appellant's witness Burnell (R. 221) testified that 8% was a fair return to enable the utility to live and continue to operate, and the witnesses Sittinger (R. 227) and Schiesz (R. 235) made their calculations on an 8% return.

In *United Railways* v. *West*, 280 U. S. 234, at 251-52 a rate of less than 7.44% was held confiscatory. The court said:

> "* * * Sound business management requires that after paying all expenses of operation, setting aside the necessary sums for depreciation, payment of interest and reasonable dividends, there should still remain something to be passed to the surplus account; and a rate of return which does not admit of that being done is not sufficient to assure confidence in the financial soundness of the utility to maintain its credit and enable it to raise money necessary for the proper discharge of its public duties. * * *"

In *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400, at 419, seven per cent was approved with the observation that recent cases support a higher rate of return. The cases there cited in a note are:

Lincoln Gas Co. v. *Lincoln*, 250 U. S. 256, 267 (7 to 8%).

Galveston Elec. Co. v. *Galveston*, 258 U. S. 388, 400 (8%).

Bluefield Co. v. *Public Service Commission*, 262 U. S. 679, 692, et seq.

Landon v. *Court of Industrial Relations*, 269 Fed. 433, 455 (8%).

Minneapolis v. *Rand*, 285 Fed. 818, 830 (8%).

Mobile Gas Co. v. *Patterson*, 293 Fed. 208, 221 (8%).

Southwestern Bell Telephone Co. v. *City of Ft. Smith*, 294 Fed. 102, 108 (8%).

New York Telephone Co. v. *Prendergast*, 300 Fed. 822, 826 (8%).

Southern Bell Tel. & Tel. Co. v. *Railroad Com.*, 5 Fed. (2d) 77, 88-89 (8%).

Brooklyn Union Gas Co. v. *Prendergast*, 7 Fed. (2d) 628, 672 (8%).

An eight per cent return was allowed in the following cases:

Brush Electric Co. v. *Galveston*, 262 U. S. 443, 445 (8%).

Consolidated Gas Co. of N. Y. v. *Prendergast*, 6 Fed. (2d) 243, 273-4, 280 (8%).

Springfield Gas & Elec. Co. v. *Public Service Com.*, 10 Fed. (2d) 252, 255 (8%); P. U. R. 1926-C 858, 864.

Kings Co. Ltg. Co. v. *Prendergast*, 7 Fed. (2d) 192, 194-5, 218 (8%) aff. 272 U. S. 579.

New York & Richmond Gas. Co. v. *Prendergast*, 10 Fed. (2d) 167, 186-7 (8%).

United Fuel Gas Co. v. *Public Service Com.*, 14 Fed. (2d) 209, 212; aff. 278 U. S. 322 (8%).

Brooklyn Borough Gas Co. v. *Prendergast*, 16 Fed. (2d) 615, 622, 638 (8%).

Interborough Rapid Transit v. *Gilchrist*, 26 Fed. (2d) 912, 924-5 (8%).

New York Telephone v. *Prendergast*, 36 Fed. (2d) 54, 67-9, (7% for telephone proper even though gas and electric companies entitled to 8%).

Michigan Bell Telephone Co. v. *Odell*, 45 Fed. (2d) 180, 182-3 (7%).

Denver Union Stock Yards v. *U. S.*, P. U. R. 1932-C 225, 238, 252, 57 Fed. (2d) 735, 745 & 754 (7½%).

New York & Queens Gas Co. v. *Prendergast*, 1 Fed. (2d) 351, 370 (8%).

VI.

What Will the Rates Yield?

Sixth Assignment of Error (R. 178).

The court erred in holding that the rates complained of would have yielded a fair rate of return, when in fact the rate of return would be less than fair and reasonable and would not exceed 5 per cent.

If appellant's entire electrical property, operated as a single unit, is held to be the rate base, then it is unquestionable that the rates will not yield a fair rate of return. In such event the rates are obviously confiscatory. This clearly appears under Point I, supra, of this argument and need not be repeated here. We merely desire to add that this contention is strongly corroborated by the uncontradicted evidence which shows (R. 280), that from 1923 to 1930 appellant has only paid dividends at an average rate of 4.36 per cent on the average amount of the par value of its common stock outstanding during that period. A summary, in comparative form, of the appraisals of the entire electrical property, with a statement of the revenue and expenses of the entire system, appears at pages 19, 21 of this brief.

If Martinsville is to be segregated from the remainder of appellant's operating unit, upon a proper allocation of the property in accordance with actual use, and upon charging a fair and reasonable "gateway" price for electrical energy, it will be shown that the rates are confiscatory.

A summary, in comparative form, of the appraisals of the Martinsville local property, with the finding of the master, appears at page 25 of this brief.

A summary, in comparative form, of the appraisals of the power system property, with the finding of the master, appears at page 23 of this brief.

If Martinsville is to be separated from the operating unit, then we believe that we have shown under Point II above that not less than 6.63 per cent of the power system property should be allocated to Martinsville use, instead of 3.3 per cent used by the master and the court. Appellant submits that in such event the property used and useful in serving Martinsville should be valued as of May 1, 1930, as follows:

Martinsville local property as appraised by Spooner & Merrill	$135,402.00
Allocation of 6.63 per cent of power system property as appraised by Spooner & Merrill	241,176.19
Martinsville rate base	$376,578.19

This valuation should be allowed instead of $204,138 (R. 167) fixed by the master and approved by the court.

The depreciable property included in the Spooner & Merrill appraisal of the Martinsville local property is $100,283 and 6.63 per cent of the depreciable power system property, included in the Spooner & Merrill appraisal, is $187,632.24, making the total depreciable property allocated to Martinsville $287,915.24.

The District Court tested the rates by charging power to Martinsville at $.0133 per kilowatt hour. We believe we have shown under Point II above that a fair charge for the electrical energy served to Martinsville would be not less than $.024996 (R. 289). This price is fixed on the basis of eliminating inter-utility deliveries (R. 289).

We believe that this is a fair method of determining the cost at the "gateway" but inasmuch as the appellees contend that an unfair burden is placed on the customers by eliminating inter-utility deliveries, the appellant has, by Exhibit 28 (R. 300) determined the cost on the basis of eliminating that part of the 66 k. v. line between Clinton, Attica and Lafayette used to make interutility deliveries, as well as the inter-utility deliveries. On the basis of eliminating both the property used in inter-utility deliveries and the inter-utility deliveries it appears (R. 300) that the cost of electrical energy delivered at the Martinsville "gateway" is $.022897 per kilowatt hour. Therefore in making the following statements appellant will use the price of $.022897 per kilowatt hour, although appellant believes that the charge of $.024996 per kilowatt hour is fair.

The revenue from the rates complained of, and expenses for the calendar year 1929 are shown to be as follows:

Operating Revenue (R. 168)		$84,750.13
Expense:		
Power—2,532,798 k. w. h. at $.022897 per k. w. h.	$57,993.47	
Other expenses, including taxes	21,349.05	
Rate case expense (R. 114)	5,180.65	
Annual depreciation—4% of $287,915.24	$11,516.60	96,039.77
Deficit		*$11,289.64

* In red.

The revenue from the rates complained of, and expenses for the year ending May 31, 1930, are shown to be as follows:

Operating Revenue (R. 168)		$81,868.72
Expenses:		
Power—2,528,511 k. w. h. at $.022897 per k. w. h.	$57,895.31	
Other expenses, including taxes	20,624.18	
Rate case expense (R. 237)	6,235.98	
Annual depreciation—4% of $287,915.24	11,516.60	96,272.07
Deficit		*$14,403.35

* In red.

The following comparative statements show the differences between appellant's statements and the tests applied by the court for the same periods (R. 168 and 169):

For the calendar year 1929:

Statement by District Court			Statement by Appellant	
$84,750.13		Operating Revenue		$84,750.13
	$33,726.13	Expenses—Power	$57,993.47	
	21,349.05	Other expenses, including taxes	21,349.05	
	400.00	Rate Case Expense	5,180.65	
62,250.54	6,775.16	Annual Depreciation	11,516.60	96,039.77
$22,499.59—Net			Deficit—*$11,289.64	

* In red.

For the year ending May 31, 1930:

$81,868.72		Operating Revenue		$81,868.72
	$33,629.20	Expenses—Power	$57,895.31	
	20,624.18	Other expenses, including taxes	20,624.18	
	400.00	Rate Case Expense	6,235.98	
61,428.54	6,775.16	Annual Depreciation	11,516.60	96,272.07
$20,440.18—Net			Deficit—*$14,403.35	

* In red.

The results prove conclusively that the segregating method is erroneous.

Minnesota Rate Cases, 230 U. S. 352, 460.

First, the master was obliged to admit that even after he had improperly reduced the appraised value of the appellant's entire property, the net revenue for the year 1929 was equivalent to a return of only 4.15 per cent (R. 131).

Second, the statement by the district court for the year 1929 shows that there would have been a net revenue available for return on the Martinsville property of $22,499.59, which is equivalent to 11 per cent on the value fixed by the district court (R. 168 and 169).

Third, the adjusting of these statements to give effect to the methods used by appellant in segregating the Martinsville property shows the Martinsville revenue was not sufficient in 1929 to pay the operating expenses, there being a deficit of $12,108.09.

When the master and court included the deliveries to other utilities in allocating the property, they allocated

one-half the power system property to inter-utility deliveries, when the undisputed evidence shows that only 89.44 per cent of the 66 k. v. line between Clinton, Attica and Lafayette is used for inter-utility deliveries and that the full value of 89.44 per cent of this transmission line is $905,979 (R. 304). It is therefore clear that the method used by them was wrong. The appellant, to meet this contention of the appellees, prepared Exhibit 28 (R. 299), by which there is eliminated from the rate base that part of the property used for inter-utility deliveries. The power sold to the affiliated utilities is credited to expense and the cost of the power delivered at the "gateways" is then divided by the number of kilowatt hours sold to all "gateways" of appellant's system, resulting in a price of $.022897 per kilowatt hour. This apportionment is clearly in accordance with actual uses and results in showing that the Martinsville revenue is not sufficient to pay the expenses of operating the Martinsville property. If it is mutually conceded that the tests applied for segregating the Martinsville property are all reasonable, then the results are at such variance that it is obvious that the principle of segregation must be wrong. The difference in the cost of power alone wipes out the net shown by the district court in its statements. The difference in the items of rate case expense and actual depreciation amounts to substantially one-half the net shown in the statement made by the district court. The rate base proposed by the district court is only 54 per cent of the rate base when the property is segregated in accordance with actual use as proposed by appellant.

The results are so variant from the system operations that it is only fair to conclude (1) that segregation of the Martinsville property is impracticable and should not be countenanced, and (2) that if segregated on the basis of actual use the rates are confiscatory.

VII.

The Rates are Confiscatory.

Seventh Assignment of Error (R. 178).

The points made in the argument lead to the conclusion that the rates fixed by the Public Service Commission in its order made January 26, 1929, are confiscatory and deprive appellant of its property without due process of law and deny it the equal protection of the law contrary to the Fourteenth Amendment to the Constitution of the United States.

The judgment of the district court should be reversed and the cause remanded with proper directions.

Respectfully submitted,

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APPENDIX.

Statutes Cited.

The Public Service Commission Act of Indiana, commonly known and referred to as the Shively-Spencer Utility Commission Act, became a law May 1, 1913.

Section 1. "That the term 'public utility,' as used in this act, shall mean and embrace every corporation, * * * that now or hereafter may own, operate, manage or control any * * * plant or equipment within the state * * * for the production, transmission, delivery or furnishing of heat, light, water or power, * * * either directly or indirectly, to or for the public.

* * *

"The term 'municipality,' as used in this act, shall mean any city or town wherein property of a public utility or any part thereof is located.

* * *

"The term 'service' is used in this act in its broadest and most inclusive sense and includes, not only the use or accommodation afforded consumers or patrons, but also any product or commodity furnished by any public utility and the plant, equipment, apparatus, appliances, property and facility employed by any public utility in performing any service or in furnishing any product or commodity and devoted to the purposes in which such public utility is engaged and to the use and accommodation of the public.

* * *

"The term 'indeterminate permit,' as used in this act, shall mean and include every grant, directly or indirectly, from the state to any corporation, * * * of power, right or privilege to own, operate, manage or control any plant or equipment, or any part of a plant or equipment, within this state, for the production, transmission, delivery or furnishing of heat, light, water or power, either directly or indirectly, to or for the public, * * * which shall continue in force until such time as the municipality shall exercise its option to purchase, as provided in this act, or until it shall be otherwise terminated according to law. This act shall be commonly known and referred to as the Shively-Spencer Utility Commission Act."

Vol. 3, Burns' Anno. Ind. Stats., 1926 Ed. Sec. 12672.

Section 9. "The Commission shall value *all* the property of every public utility actually used and useful for the convenience of the public."

Vol. 3, Burns' Anno. Ind. Stats., 1926 Ed. Sec. 12680.

Section 11 provides that within five days after such valuation is determined, a statement thereof shall be filed with "* * * the clerk of each municipality in which *any part* of the plant or equipment of such utility is located."

Vol. 3, Burns' Anno. Ind. Stats., 1926 Ed. Sec. 12682.

Section 12. "The commission may, at any time, on its own initiative, make a revaluation of such property."

Vol. 3, Burns' Anno. Ind. Stats., 1926 Ed. Sec. 12683.

Section 18 provides that the utility shall have an office "• • • in one of the towns or cities of this state in which its property, or *some part thereof*, is located and shall keep in said office all books, accounts, papers and records."

Vol. 3, Burns' Anno. Ind. Stats., 1926 Ed. Sec. 12689.

Section 41 of the act provides that every public utility shall file with the commission schedules showing all rates "• • • which it has established and which are enforced at the time for any service performed by it *within the state.*"

Vol. 3, Burns' Anno. Ind. Stats., 1926 Ed. Sec. 12712.

Section 47. "It shall be unlawful for any public utility to charge, demand, collect or receive a greater or less compensation for any service performed by it within the state, or for any service in connection therewith, than is specified in such printed schedules, including schedules of joint rates, as may at the time be in force, or to demand, collect or receive any rates, tolls or charges not specified in such schedule. • • •"

Vol. 3, Burns' Anno. Ind. Stats., 1926 Ed. Sec. 12718.